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IDEAS ON LIBERTY

Are Credit Card Interest Rates Too High?

Who Is an American?

Hyperinflation Threatens Brazil

JANUARY 1988

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IDEAS ON LIBERTY

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1988
VOL. 38
NO. 1

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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
President of
the Board: Robert D. Love
Vice-President
of Operations: Robert G. Anderson

Senior Editors: Beth A. Hoffman
Brian Summers

Book Review Editor: Edmund A. Opitz
Contributing Editors: Bettina Bien Greaves
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Paul L. Poirot

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $10.00 a year is required to cover direct mailing costs.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

The Uncertain Economy

American businessmen are frequently criticized for focusing on short-term profits, while ignoring the need for long-term planning. But, how are businessmen supposed to make long-range plans when tax laws, import quotas, regulations, and monetary policy are constantly changing? As UCLA economist Axel Leijonhufvud points out (*Money in Crisis*, edited by Barry N. Siegel [Ballinger Publishing Company], 1984):

"The product designer who can come up with a marginally improved or more attractive product, the production manager who in a good year can increase the product per man hour by a percent or two, the vice-president of sales who might reduce real distribution costs by some similar amount, are all examples of roles that have become less important to the stable functioning or survival of a corporation. Other functions requiring different talents have increased in importance. The vice-president of finance with a talent for adjusting the balance sheet to minimize the real incidence of an unpredictable inflation is one example. The creative financing artist floats to the top in real estate. But the wise guy who does a good job at second-guessing the monetary authorities some moves ahead is the one who really counts. Smart assessments of the risks generated by the political game in Washington outweigh sound judgments of conventional business risks."

For a thoughtful analysis of government-generated uncertainty, see Ridgway K. Foley's article on page 11.

To Have and to Share

"To drink coffee I do not need to own a coffee plantation in Brazil, an ocean steamer, and a coffee roasting plant, though all these means of production must be used to bring a cup of coffee to my table. Sufficient that others own these means of production and employ them for me." With these words, the Austrian economist Ludwig von Mises (1881-1973) dramatized the workings of the market.

There are two kinds of "having," he pointed

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out—a direct "physical having" and an indirect "social having." A self-sufficient farmer who lives outside the market and produces everything he and his family consumes, can use his land, tools, and farm animals as he chooses. He need not share them with anyone. He *has* them in a total sense, both directly and physically.

But the individual who produces for the market must consider his customers. He may possess his means of production in the legal sense, but his customers, through their purchasing decisions in the marketplace, tell him how to use them. And, to prosper, he must share his output with them. His customers *have* the means of production and the use of these means in the social sense.

This system of *having*—the figurative sharing of the tools of production among producers and consumers—has led over centuries to a complex system of finely specialized production and trade. This complex system furnishes us with goods, services, cultural benefits, and leisure, unknown to our ancestors, unknown to the self-sufficient farmer.

If something goes awry with this system, we often blame producers and ask government to force them to change their ways. Now it is true that a producer may misjudge the market. He may misread the directions of consumers and produce something they will not buy. But the consumers have the upper hand. If a producer fails to respond promptly to the wishes of consumers, they will take their purchases elsewhere, and he will soon be out of business.

Through the process of social *having*, consumers over the years have led producers to manufacture automobiles instead of carriages, to produce electricity instead of candles, to make ready-to-eat breakfast foods, cooking mixes, easy-to-care-for clothing, electrical tools and appliances, and so on. No producer is so big or so powerful as to be immune from the wishes of consumers.

—BBG

Saudi Wheat

While the U.S. government has spent billions of dollars in trying to make the United States "energy independent," the Saudi Arabian government has expended billions of dollars in trying to make Saudi Arabia "wheat independent." Dennis D. Miller reports in *The Wall Street Journal* (September 3, 1987):

"In 1981 [Saudi Arabia] grew only 187,000 metric tons of wheat, importing the rest of its needs. Now self-sufficient in wheat, Saudi Arabia grows nearly two million metric tons a year.

"But that self-sufficiency came at the cost of giant subsidies. . . . The Saudi government pays domestic growers $1,000 a ton for wheat that could be bought on international markets for $80. In other words, Saudi Arabia paid $2 billion for wheat it could have bought for only $160 million. . . .

"Of course, Saudi Arabia offers the same reason, national security, that the U.S. offered in the 1950s for its quotas on petroleum imports. And as the U.S. policy accelerated the rate of depletion of U.S. petroleum reserves, the Saudi policy is accelerating the depletion of Saudi Arabia's water."

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Hyperinflation Threatens Brazil

by Lawrence W. Reed

Imagine a place where prices of nearly everything change by the week—and always upward.

Coffee up 50 per cent in two months, while a McDonald's hamburger more than doubles. Hotel rooms rise 110 per cent in just 30 days. Supermarket employees spend half their time at the shelves—replacing old price stickers with new ones. Restaurant menus wear thin from the frequent erasures of prices penciled in. Interest rates for a one-month bank loan—25 per cent—are higher than what Americans pay on their credit cards in a year.

This is Brazil, a South American giant gripped by runaway inflation that threatens to sink both its economy and its fledgling democracy.

For ten days in April 1987, I examined hyperinflation in Brazil's vast, beautiful, critter-infested steam bath we know as the Amazon region. Far from the country's monster cities of the south (São Paulo alone boasts a population of 15 million), I talked to dozens of people in three towns: Belém, a port city near the mouth of the Amazon with a population of a million; Santarém, a town of about 100,000 people 300 miles upriver; and Alter do Chao, a village of about 1,000 on the Tapajós River, about 30 miles from where the blue-green Tapajós flows into the muddy Amazon at Santarém.

The Amazon rain forest is an exotic place for any activity, but it can be uncomfortable for someone accustomed to a dry climate. Water thickens the air and drenches the earth in superabundance.

One-fifth of all the fresh water on the planet flows through the mighty Amazon. As it pours into the Atlantic, it drives back the salt water of the ocean for more than 100 miles.

Ocean-going ships can navigate for 2,300 miles up the river's 4,000-mile length. More than 1,500 species of fish inhabit the Amazon and its 1,000 tributaries, in a basin which drains an incredible 2.5 million square miles of mostly jungle territory.

But water isn't the only thing of which this nation of 135 million seems to have more than enough. It's drowning in paper money, too, which explains why the value of the stuff plummets with each round of price hikes. The administration of President José Sarney, an ill-fated one from the start, is getting most of the blame for it.

In 1985, 21 years of military rule ended with the election of Tancredo Neves to the presidency. Before ever taking office, however, Neves died.

His vice-presidential running mate was Sarney, a poet and politician of little note who suddenly found himself wrestling with the accumulated economic problems the military had willingly deserted. He succeeded in making them worse by boosting public spending and printing more money to help pay for the 50 per cent of Brazil's gross national product that the government was consuming.

By early 1986, inflation in Brazil was running at an annual pace of 400 per cent. In February of that year, Sarney startled the nation with a dramatic announcement: To end the inflation, he was freezing wages and prices and reforming the currency. Three zeroes were dropped from the old "cruzeiro" and a new money, the "cruzado," was introduced.

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While the freeze was in effect, the government ballooned the spending of the public sector, fostered a yawning budget deficit, and tripled the money supply.

Sarney "deputized" the nation's housewives to report on price violators and sent swarms of armed men onto cattle ranches to force owners to sell their beef at fixed prices. Goods vanished from store shelves as black markets flourished. It was like clamping a lid on a boiling kettle and turning up the heat simultaneously.

The whole thing blew up in February 1987, as the president was forced to lift the controls and, in a move that sent shock waves throughout the world's financial community, suspend interest payments on most of Brazil's $110 billion external debt.

The economy seems to be careening toward an abyss, with no one sure of what the future will bring. The prestigious financial magazine, *The Economist* (February 21, 1987) put it this way: "Brazil's economy is going downhill so fast it may jump the rails."

Talking to consumers and vendors in Belém's famous Ver-O-Peso Market, I discovered widespread skepticism about the government's inflation figures. Rather than the 400 per cent officials proclaim, the consensus in the street is that the real rate is much higher.

"The clothes I would like to buy are three times in price what they were last month," one woman complained bitterly. And like everyone else I spoke with, her wages had not kept pace, in spite of the widespread practice of "indexing" wages to the inflation rate.

"Business is way down," lamented a seller of hammocks, "and with interest rates at 25 per cent per month now, I can't afford to borrow anymore." He blamed the collapse of his customers' purchasing power for the loss of business.

"No one saves and no one plans for anything beyond today," another shopper told me. "As soon as you earn cruzados, you get rid of them, either for dollars or for something that's real."

The inflation seems to have accentuated class divisions. A common complaint is that "the not-so-rich are getting poorer while the rich hold their own or get richer."

"The rich can find ways to protect themselves, but inflation is doing to the poor and middle class what the piranhas of the Amazon do to a cow in the water," a vendor of wicker baskets said. Piranhas are those carnivorous fish with teeth like a newly sharpened saw and a disposition to match. Schools of them have been know to clean a live cow to the bone in half an hour.

Labor strife and civil unrest appear to be on the rise as a consequence of the deteriorating economy. Some residents spoke of mutiny on the railroads because of a rail strike. Dockworkers are threatening to shut down Brazil's port cities. In the banks of São Paulo, an average of 13 assaults per day occur against bank employees. Rumors of a military coup

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are on the rise throughout the country.

In Santarém, I gathered detailed price information on several dozen items. "What did this sell for one month ago, and what is its price today?" I asked many of the vendors. Here's a sample of what I found:

"Glymiton," a popular liquid vitamin supplement: from 24 to 60 cruzados (about 26 cruzados equals $1); a one-kilo roll of twine: from 111 to 390 cruzados; a cup of mineral water: from 2 to 5; a spool of fishing line: from 60 to 90; and one kilo of meat: from 20 to 70.

Businessmen complain of shrunken inventories and shortages because of the evaporation of credit.

"We used to get supplies and pay for them 30 days later," a hardware store owner told me. "Now," he said, "everyone wants cash up front."

"It's ironic," a restaurant manager said, "that my suppliers demand immediate payment from me in this worthless paper, only to turn around and get rid of it themselves."

At the Aparecida Hammock Factory in Santarém, the best hammocks of the region are made. Automation hasn't come to this place yet. The hammocks are hand-woven on giant wooden looms by craftsmen who work with lightning speed over the intense clacking of fast-moving shuttles. Profits from sales are given to the Catholic Church to support social welfare programs. I asked the manager how inflation has affected the business and heard a familiar story.

"We have been hit hard," the manager said. "Tourism is down and even local people aren't buying like they used to. There are needy people who depend upon our success here who will have to do with less this year. It's sad, but what else can we do?"

When asked where things are going from here, everyone expressed either complete uncertainty or outright pessimism.

"These problems represent the worst crisis in our memory. We have no way of knowing what lies ahead," a hotel manager said.

In Alter do Chao, several people suggested that the main cause of the inflation was the government's massive external debt and that the solution was for Brazil to go further than Sarney's suspension of interest payments and cancel the foreign debt unilaterally and entirely.

Some blamed the United States for "suckering" Brazil into the debt dilemma in the first place, but anti-American sentiment did not seem to be much a part of people's thinking anywhere I traveled.

One of the few enterprises that the inflation actually may be helping is gold prospecting. In fact, Brazil is in the midst of one of history's greatest gold rushes.

Nearly half a million "garimpeiros"—individuals working with little more than a pick and shovel or a pan at the riverside—hauled out nearly 80 tons of gold from the Amazon region last year. The Brazilian minimum wage of $70 per month does not affect them, for they earn whatever the gold they find fetches them, and not an insignificant number have made a fortune.

I talked to one of the officials at SUDAM, the government agency that supervises the development of the Amazon area, about the gold discoveries. The richest find, in a place known as the Serra Pelada, "may solve Brazil's debt problem one day," he confided. "If the gold doesn't do that for us, maybe the oil will; we think we are sitting on a vast sea of oil here in the Amazon."

It's hard to imagine enough gold or oil to bail Brazil out of its present difficulties in time to prevent upheaval. This is not an economy with a lot of time to work on its troubles. The specter of worsening inflation, depression, and political turmoil clearly stares it in the face.

Sadly, the Brazilian government seems to have learned little from the last two years of chaos. In June 1987, it announced a new program which includes another round of wage and price controls. That same month, the money supply increased 28.8 per cent.

This is not the first hyperinflation the world has witnessed. It isn't the first Brazil has had, either. But seeing it firsthand and sensing the pain and confusion it engenders make one wonder why it has to happen at all. Surely one of the most enduring lessons of economic experience is that drowning a nation in paper money always wrecks the currency and the economy along with it. It's a lesson Brazil is learning now in a most painful way. □

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Hyperinflation: Lessons from South America

by Gerald J. Swanson

How would you like to live in an economy without memory, where you don't know the price of anything day to day or the value of the wage you are paid? That's what it's like under hyperinflation. In Argentina, supermarket prices are increased twice daily. During the two weeks we were in Brazil recently, interest rates rose 100% from 330% to 430%. Bolivia's demand for money is so great that its third largest import is currency.

Inflation, to say nothing of hyperinflation, seems to be the forgotten bandit of the eighties. Inflation was once the chief scourge of every respectable U.S. economist. Today we seem to have other things to worry about: pockets of severe unemployment, a lack of competitiveness internationally, the fear of a recession, even the possibility of disinflation.

The chief reason inflationary concerns have abated is that, contrary to traditional economic theory, the huge U.S. federal deficits of recent years have not yet translated into spiraling prices. Until this decade, the postwar years had demonstrated a direct correlation between deficits and inflation. When deficits rose, price and interest rate increases were sure to follow. During the past six years, however, the annual deficit has almost tripled, with the national debt almost doubling, but nominal interest rates have actually fallen.

Whatever the reason for this aberration, we can consider ourselves fortunate. But for how long? Most economists would argue that the trend is simply not sustainable. South American countries such as Argentina, Bolivia, and Brazil—all of which have suffered annual inflation rates into the triple digits in recent years—offer conclusive proof that no country can indefinitely get away with spending more than it makes. The United States has something to learn by the plight of these countries. It would be a mistake to write them off as hopelessly backward, having no relevancy to such a powerful, sophisticated economy as ours. Argentina as recently as the 1920s was the fifth most productive nation in the world. Now it is 70th, with hyperinflation the major culprit.

At a critical juncture, Argentina, Bolivia, and Brazil were not willing to bite the bullet and take the steps necessary to prevent high inflation. Make no mistake about it, neither is the United States. We all seem to share a love affair with the hot fudge sundae diet; the notion that we can eat as much as we like without getting fat. But eventually the piper has to be paid. Increasing the amount of currency circulating in an economy in order to pay off debt, without increasing production, will inevitably lead to higher prices. In each country we visited, large deficits and high inflation go hand in hand. And when runaway inflation starts, it moves quickly . . . in a matter of months, or even days!

To a certain extent, it is the fluctuation in inflation rates that is difficult to live with, rather than the rates themselves. Argentina learned to cope with 100% annual inflation, but when it rose to 500% the result was virtual

Dr. Swanson is Associate Professor of Economics at the University of Arizona. This article, reprinted from the 1986 Annual Report of Figgie International Inc., reports on his study of hyperinflation in Argentina, Bolivia, and Brazil.

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chaos. In the United States we've become accustomed to 5% inflation, but a sudden increase to 20% would profoundly change our economic realities. In fact, even 5% took some getting used to. When President Nixon imposed wage and price controls in 1971, the national inflation rate was a whopping 4.7%.

The Consequences of Hyperinflation

What would life be like in the United States with an inflation rate of 20% or more? South America offers a number of clues. At one time in Argentina, a pair of shoes cost as much as an entire steer. With hyperinflation, prices cannot be used as benchmarks for decisions, since yesterday's prices do not offer any relevancy for today. In fact, it isn't unusual for South American shoppers to see the price of bread increase between the time they enter a grocery store and the time they leave it. Savings lose their value. The only incentive is to spend. Paychecks are cashed immediately and turned into hard goods like washing machines, refrigerators, and radios. And that's assuming they are available. Consumers are forced to pay cash for everything, including homes. Above all, political and social certainty is lost.

In the United States we are accustomed to stability. We know that if today $300 is a good price for a 19-inch color television set, it will be an equally good price tomorrow. Not so in the South American economies we are studying. Beset by hyperinflation, it is nearly impossible for individuals to judge their status in life, since status is so closely related to the control over what they are able to consume.

As a political problem, inflation is much more illusive than, say, unemployment, which simply provokes a call for more jobs. Citizens don't necessarily demand an end to inflation, only to the personal hardships that result. Once wages are tied to prices so that people can be assured that their purchasing power is not damaged, they are usually satisfied. In that case, another problem actually arises when inflation is temporarily curbed and wage increases are halted. Workers tend to feel they are worse off when their monthly paychecks no longer increase routinely. Governments also become accustomed to inflation, using it as an all-too-easy way to lower their outstanding debt.

In these three South American countries hyperinflation has created more wrongs than legislators can put right. In order to protect industry, governments have been known to close their borders, which might help domestic companies in the short-term, but makes long-term competitiveness impossible. Unchecked hyperinflation inevitably plays havoc with an entire nation's standard of living. The need to survive begins to dominate individual actions, making long-term planning impossible. During hyperinflation, short-term is considered three days; long-term, two weeks. According to a top executive at Banco Palmares, "The name of the game in terms of planning during periods of high inflation is guessing what ways the government is going to try to correct their bad choices."

For individual businesses, good management is always a crucial ingredient for success. We found that during hyperinflation it becomes even more critical. New information must be absorbed rapidly, because today's political or monetary event can negate yesterday's wise business decision. In Brazil the government recently gave approval to automotive suppliers to increase the price of stainless steel by 60%. Such business decisions are needed to reassess inventory levels and production scheduling. A thorough knowledge of financial and currency markets is vital, since managing a company's money could become more important than increasing sales or even productivity.

During high inflationary periods, managers turn from production management and long-term planning to financial arbitrage in order to make short-term profits by borrowing dollar denominated funds and lending them in local currency. Many South American companies invest their money in other countries, or at least place their assets in a more stable currency, which in the past has been the U.S. dollar.

Some of the most successful South American companies make collections in seven days, while delaying payment for thirty days or longer. Prices are increased rapidly, and inventories are often built up and warehoused, with expectations of selling them in the future at substantially higher prices. Other South American companies cope with hyperinflation

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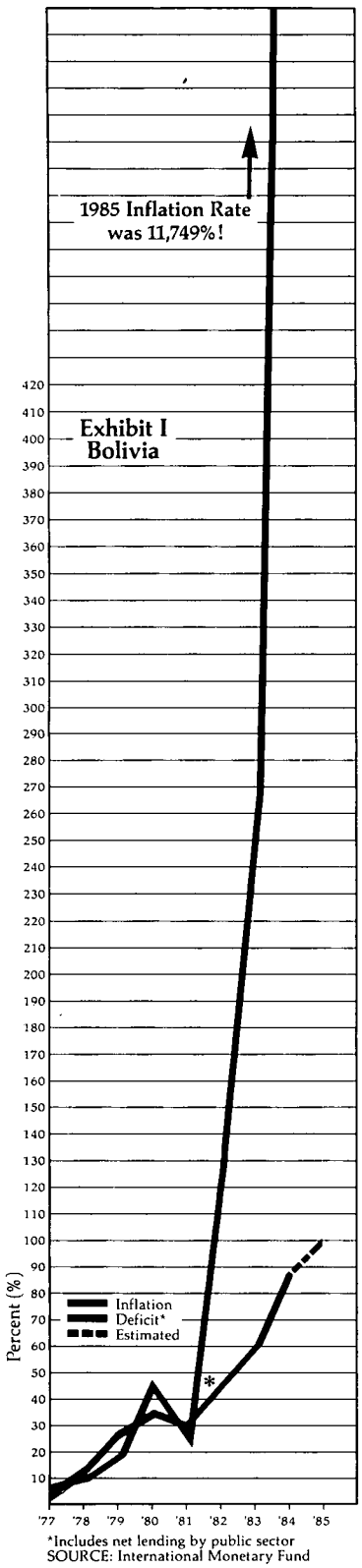
HYPERINFLATION IN BOLIVIA, BRAZIL, AND ARGENTINA



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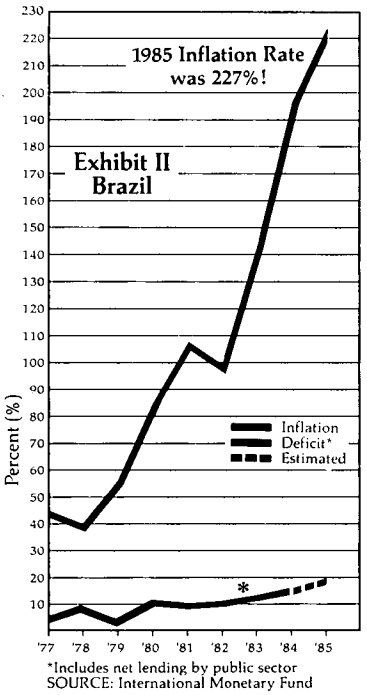
SOURCE: International Monetary Fund



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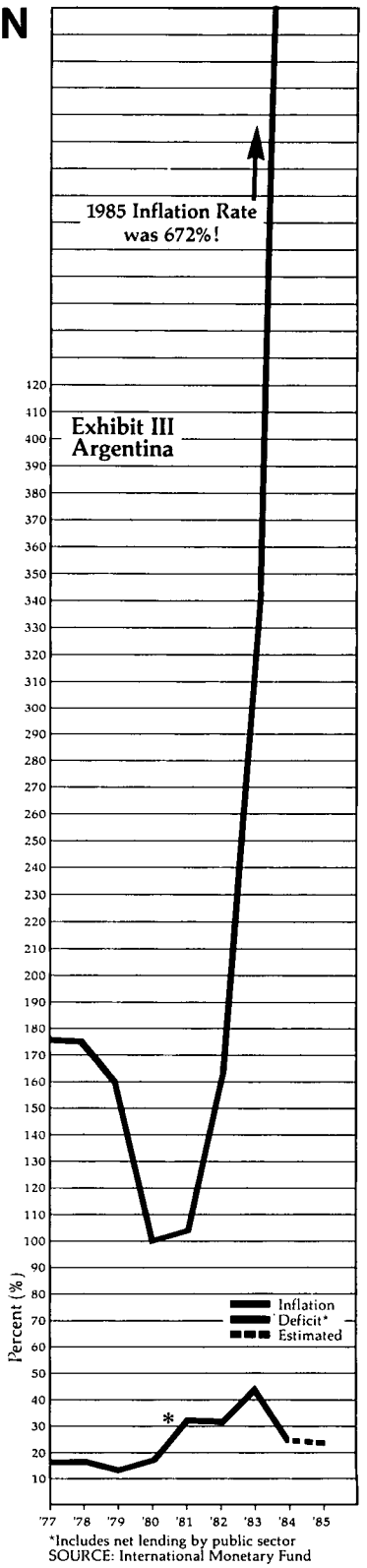
SOURCE: International Monetary Fund



*Includes net lending by public sector
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through a strategy of vertical integration. In other words, by acquiring raw materials and production and distribution facilities, some concerns have been able to minimize the impact of price fluctuations, as well as government regulations.

Because events occur so rapidly under hyperinflation, those companies who can maintain their flexibility are best off. In many instances, a one-day delay in making or implementing a decision can be devastating. Often there isn't time to put orders in writing, so effective oral communications are vital. But at some point flexibility becomes the antonym of stability, and taken to its extreme creates chaos. How is a Brazilian firm, faced with an annual interest rate of 70% in November of 1986, supposed to make a proper investment decision when 90 days later the actual interest rate on loans soars to 550%? Neither individuals nor businesses can be heavily leveraged since interest rates are so unpredictable. It is enough to cause even the best laid plans to fall apart.

Once hyperinflation becomes a reality, politicians inevitably succumb to the lure of legislating it out of existence. During the past decade, Argentina, Bolivia, and Brazil all at one time or another addressed their hyperinflation problem with the simplest of solutions; they outlawed it. While government intervention often has a short-term salutary effect, making it irresistible to politicians, in the end all governments—including our own—have had to conclude that more fundamental solutions are needed to attack the root of the problem, not just the symptoms.

In 1986, President José Sarney of Brazil, in an attempt to do something dramatic about an inflation rate that threatened to soar to 500% or more, instituted an anti-inflation program that froze prices, controlled wages, and lopped three zeroes off the Brazilian currency. The plan succeeded in temporarily curbing inflation, but higher prices were quickly replaced by other problems. Severe shortages of daily necessities such as eggs, meat, and milk developed. Black markets quickly filled the vacuum, resulting in higher prices that didn't show up in official inflation figures.

White-collar crime inevitably increased as well, as a never-ending spiral began, with the government implementing a maze of regulations and citizens just as quickly developing innovative strategies to evade them. One distributor of heavy machinery told us that because used equipment is not subject to wage and price controls, he routinely leases for a month or two, then turns around and sells the equipment at twice its original price. Many companies get around wage controls by giving their employees loans that are not expected to be repaid. In all three South American countries we are studying, this kind of subterfuge, necessary as a means of survival, gives a sense of legitimacy to breaking the law, threatening a nation's moral fiber. "Inflation," a top South American officer of the Bank of Boston told us, "is an immoral tax that leads to immoral values."

Because hyperinflation can so easily become a way of life, the best—some might say the only—foolproof solution is to avoid it in the first place. Once underway, hyperinflation can only be thwarted by a painful reduction in government spending and by a halt to the printing of money not backed by the production of real goods and services. As the noted author Peter Drucker likes to say, "You can't consume what you haven't produced."

Hyperinflation is by no means a certainty for the United States, but we have managed to create conditions conducive for its arrival. In investigating what the lessons from South America can teach us, we have taken a "What if?" approach. As a further caution, however, it is important to note that in coping with hyperinflation, South America has had one weapon at its disposal that would be unavailable to us. At least these countries have a world currency to fall back on. The U.S. dollar provides them with some measure of stability. But in the event of hyperinflation in the United States, what currency could we turn to? ❑

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Invasive Government and the Destruction of Certainty

by Ridgway K. Foley, Jr.

Law exists. It exists in the inexorable rules of consequence which govern the universe, including the inescapable rules attendant upon human action. It exists in positive or man-made rules and orders imposed by human beings, acting singly or in concert, upon other men.

Men search for justice as a quality of law in both senses of the term. If a precise and acceptable definition of law has eluded scholars and students, so also have the quality and the essential characteristics of justice proven chimerical. Attempts at definition often produce tautologies; attempts at analysis often bring forth murk. Solutions to such eternal and complicated inquiries sometimes commence with simple beginnings, and this essay addresses one simple element of justice prevalent in the common law tradition, the requirement of predictability.

I. Predictability as an Aspect of Justice

A commonplace tautology equates justice with fairness, without any feint at content or elucidation. Nonetheless, "fairness" in the common law tradition gives birth to the beguiling beauty of equality. Equality, in the guise of Cain, cultivates a leveling egalitarianism, quite apart from sound tradition or good sense. Equality, in the garb of Abel, calls for like treatment in similar situations: it is "fair" or "just" if commoner and king each must keep their uncoerced promises, avoid trespassing upon the next-door neighbor's land, and restore gains secured by deception and malevolence. The grand phrase, "equality under the law," properly conveys no more than this notion.

Certainty represents an essential component of this sort of fair or just behavior. Occupants of all stations in life start legally equal if each individual understands that similar responses will follow like acts or omissions. The common law participated in a sentiment that every man should know the law and govern his actions accordingly. This presumption—less a fiction in the fifteenth century than in the twentieth—obviated any defense of the unintended consequence; one could not avoid an unpleasant outcome by the subjective assertion that he did not understand his act to be unlawful, or that he did not contemplate a specific binding result. Derided by some modernists as unduly formalistic, the certainty of the common law allowed men to organize their activities and to accommodate their behavior to regular, common, known rules of order, similar in concept to the natural rules of order of the physical and praxeological universe.

II. Two Aspects of Certainty

Each individual participates in a search for certainty. The desire for predictable consequences inheres in each of us. Men cannot function in a random world; a rational aspect compels us to behave in a manner consonant with anticipated results. Hence, if we lived in a

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universe where the sun rose in the east one morning, in the west the next midday, and not at all during a third discrete period of time, none of us could carry on an existence bearing any semblance to life as we know it. If our actions produced highly irregular results, if our attempts to communicate afforded outrageous responses, if our physical world displayed no orderliness, all sanity would disappear forthwith. Order, regularity, and certainty represent necessary touchstones for human endeavor since development and achievement presuppose a natural order and a capacity to cope with, and learn from, our nature and our world.

Nonetheless, consider this countervailing truth: It is possible, indeed likely, to seek a predictability beyond our ken. If men possessed perfect hindsight and foreknowledge, if they could be "as gods" (Gen.3:5), a perfect predictability, an absolute certainty, would appertain. Each actor would understand causality and responsibility perfectly, and each act would bring forth precisely intended results. While such a utopia would not need to deal with the unintended consequence and with the thwarted expectation, the issue of moral conduct would remain to perplex that supposed society of perfect knowledge. A presupposition of absolute certainty need not necessarily incorporate an assumption of propriety: an all-knowing being could will to destroy or enslave his neighbor as the tyrants of the twentieth century have so amply demonstrated.

Of course, no such perfect knowledge appertains in the real world. One is tempted to add that no unflinching regularity appears in our life and in our world; to yield to such a temptation is to suffer seduction by a pervasive siren. Analysis compels the student to differentiate the orderly natural world from the imperfection of the human actor. The natural order consists of perfect regularity by definition: It is rational and not random, and effect follows cause in an inexorable fashion. Human behavior—part of that natural universe of things, forces, and events—likewise calls forth predictable and certain results.

The sticking point resides in the finity of mankind: to turn Niebuhr's thought counterclockwise and to render it more accurate, we are "disorderly men in an orderly universe." Our world, including the results of our activities, is perfectly predictable, yet our knowledge lacks such perfection. We assess historical causality poorly, if at all; is it any wonder that we consistently skew our predictions for the future? If any individual understood the past and could comprehend the future, he would achieve unparalleled material success: Such a lawyer would win every case and receive both prompt and full payment of his fee; such a physician would cure every patient, for he would avoid the incurable and the noncomplying; such an investor would purchase only stocks that soared, and he would sell them at their zenith.

The jurisprudential concept of certainty, then, must be perceived against this curious backdrop of human duality. Man requires regularity, yet a quest for absolute certainty proves to be a vain and unproductive act. An appropriate philosophy of law must accept the inherent regularity and perfection of the natural law of cause-and-consequence; concurrently, it must assess the role of a man-made law (posited rules and orders) designed to govern human beings who cannot survive in a random, rule-free world, and who crave predictability even to the point of impossibility, given man's flawed nature. Moreover, the scholar must never overlook the flawed nature of the *maker* of positive law: no man possesses any demonstrable edge over others in the management of human affairs other than his own!

Hence, the issue of legal certainty thrusts an incredibly complex equation before us. Review these factors, from the myriad which concatenate to cause our perplexity:

(1) An orderly natural universe of great complexity;

(2) Myriad individual actors inhabiting that universe, exhibiting these traits, among others:

(a) Incomplete knowledge

(b) Variable knowledge among members of the species

(c) Positive and sinister motives

(d) Inability to function in a random environment

(e) A desire for absolute certainty;

(3) A necessity for positive rules and orders to allow societal development, e.g.,

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resolution of disputes and prevention of aggression;

(4) A disharmony between some positive law and the overriding natural law;

(5) The creation and application of positive law by individuals beset with the very limitations observed in point 2 above.

III. Common Law and Continental Tradition: A Comparison

One salient inquiry within this complicated matrix is whether, and to what extent, positive law provides, and ought to assure, predictability. Once again, recourse to the history of our common law affords essential insights. The codified Continental tradition differs mightily from the common law in several particulars, e.g., a professional class of decision-makers, an absence of community adjudicators, a strict bureaucratic formalism, and a denial of the individual rights tradition.

For our present purposes, the overweeningly remarkable and disparate attribute of the Continental system of jurisprudence appears in the imposition of pre-existent and detailed codes of conduct upon a society already fettered by the absence of individual decisional rights and by the presence of control by a professional adjudicatory and administrative class. Most systems of law outside of the Anglo-American mainstream proceed from the premise that all power inheres in the state; the state may cede some powers to inhabitants and perhaps label those choices "rights," but the power to convey incorporates the power to reclaim. The state in this conceptual framework prescribes and proscribes human activity by means of detailed codes, edicts, and decrees, customarily written in the more advanced nations, emanating from the sovereign monarch or legislative body. In essence, the modern codifiers differ little from Hammurabi, Justinian, and Napoleon.

Clearly, the Continental practice calls forth many conceptual and practical difficulties. In the present context, pervasive codes establish the apex of formalism. Human beings must act, or refrain from acting, precisely as set down by the single or collegial dictocrat. The administrator represents the worst of bureaucratic myopia: If the code contains no specific directive, activity must cease, for the state cannot countenance interstitial innovation. Prior restraint cuts off the chain of creative consequence, grubbing out the bud of change.[1] No matter that human frailty prevents any king or parliament from anticipating all possible (or even likely) choices and events, and from setting forth clear and wise rules governing all related circumstances in advance; one fact holds invariably true: Six millennia of recorded failure has not diminished the social tyrant's zeal significantly.

Simply put, the Continental system at its most zealous represents the climax of the human predilection for perfect certainty observed heretofore. Perversely, that quest for predictability proves useless: A codified world may be sterile, dull, and uncreative, but it certainly is not necessarily predictable, except to the extent that stultifying positive law always impedes human creativity and betterment.

Common law theory proceeded from radically different conceptual premises. In the first place, an evolving concept of natural, individual rights early eroded the authoritarian and absolutist English monarchy. True, Great Britain suffered under venal tyrants and false doctrines, in similar fashion to other nations. Nonetheless, at least as early as the Magna Carta, the subject intruded upon the sovereign's self-proclaimed habitat, and compelled a declaration of rights quite apart from privileges transitorily ceded by the state.

At least five centuries witnessed the ebb and flow of the struggle between power-corrupt demigod and resistant citizen. From the Magna Carta to Lord Coke and beyond, the individual slowly established the theoretical base from whence emerged the individualistic political theory of John Locke and the incipient market economic analysis of Adam Smith. While it remained for the fledgling United States to give full bloom to the fragile flower of liberty, certainly the nineteenth century witnessed the blossom throughout much of the Anglo-American world, in thought if not completely in deed.

In the second place, the common law tradition proceeded upon tenets more fearful of prior restraint than the Continental premise. The common law operated on the notion that

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law existed, to be found by the judge and applied to concrete situations and real disputes. Certainly, English Parliaments enacted statutes, and British administrators provided some desultory regulation, but for centuries the common law decried pervasive codification as unworkable and unwise. Instead, the common law permitted free development of human choice without inhibiting pre-existing rules; when the interests of two or more individuals appeared to collide, and the parties could not settle the matter amicably, the dispute was brought before one of the king's courts for final resolution.

The judge sought to adjudicate by reference to pre-existing general principles which he applied to the case at hand; the jury—a device rooted in the Saxon Witan and significantly different from any institution in the Continental scheme—evolved as the body which applied the community standard of justice to the resolution of factual disputes. Unlike the Continental counterpart-edifice, the jury arose from the community, served its purpose, and returned to its daily life; the judge gained office after service at the bar or in other distinguished roles; neither jury nor judge represented a professional class of decision-maker in the mode of the rest of Europe.

IV. The Decline of Juristic Certainty

At the turn of the twentieth century, the jurisprudential analogue to John Dewey and John Maynard Keynes commenced a campaign of derision against the common law tradition. The Instrumentalists, led by Oliver Wendell Holmes, Jr., Karl Llewellyn, Roscoe Pound, and Lon Fuller, railed against "formalism" and in so doing subverted the unique Anglo-American system so carefully constructed over the centuries. From shallow beginnings, the Instrumentalists seized control of the robes in less than a half-century; today, save for a few splinter movements of little merit and less persuasion, the Instrumentalist revolution is complete[2] and few thoughtful voices of rebuke can be discerned above the babble.

The Instrumentalist attack focused upon legal method and produced a shaky and unpredictable relativism in place of the substantial certainty unique to our heritage. The Instrumentalists criticized their "formalistic" precursors for dryly logical reasoning, for an internal legal symmetry borne of predictability, and for their perceived indifference to "social effects." As a result of this frontal assault upon the established order, the radical realist substituted sociology for jurisprudence and *ad hoc* jural orders for predictable results. In the course of this enterprise, the law has become a gigantic game show, with the prevailing litigant resembling the successful contestant capable of guessing correctly if fortuitously.[3]

Pertinent to our concern with certainty is the Instrumentalists' criticism of what they pejoratively termed "the theory of legal abundance." A pinion of common law theory considered all legal principles to be pre-existent, all-encompassing, complete, and comprehensive; as a consequence, the judge merely found and applied the law to a dispute set before him.

The Instrumentalist challenged this view: He argued that law is, or ought to be, nascent, fragmentary, and inchoate in all manner of ways, leaving great latitude to the lawmaker to sculpt rules and orders to fit particular situations and to meet changing times. As in most ideological altercations, inept phrases and muddled values inhibited the Formalist/Instrumentalist combat. The fundamental soundness of the common law lay in its resistance to prior restraint and in its allegiance to a belief in an overriding natural law to which all positive law ought to conform in order to achieve the best possible (but not perfect) result. In truth, the principles "found" and applied by the King's Bench, the Court of Common Pleas, and later, in the commercial Law Merchant, reflected emerging principles necessary to a free but orderly society.

Few articulate defenders of natural law would assert that all juridical principles for all time are written down in a code-book, wherein the clever judge can turn to just the right page and find his solution. Rather, certain rules of order and causality apply to human action, just as precisely as the physical rules of gravity and thermal dynamics govern the corporeal universe; adherence to these rules of human action in resolving disputes—as nearly as any fallible being can follow precise principles—will, on the whole, produce the most harmonious out-

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"Mankind is neither perfect nor perfectible; we are *individuals* capable of improvement, but the best of us always fall short of the standard."

come. The misplaced Instrumentalist derision replaced a relative certainty and a societal open texture with an unhappy formless formalism, where prediction becomes the exception, not the rule, and all of us reside at the whim of today's lawgiver.

One should not lay sole responsibility for the deterioration of legal certainty at the Instrumentalist door. Nor should one indulge in the supposition that a perfect predictability flourished in, say, the eighteenth or nineteenth centuries, only to be obliterated in a recent *coup d'état*. The seeds of Continental-style staleness flourished, to a greater or lesser extent, throughout our juridical history, and the ultimate culprit may well be an aspect of human nature to which the Instrumentalists pandered.[4] After all, while man craves predictability, he likewise displays traits of envy, arrogance, and tyranny which, plied with a false assurance of certitude, guarantee his downfall.

Those who slight the Socratic dictum ("I know not; yet, I know that I know not.") presume to assess causality accurately and events comprehensively, and to practice perfect morality. Despite their affectation of correctness, they misapprehend the nature of man and the order of his universe; therefore, they necessarily come a cropper.

Mankind is neither perfect nor perfectible; we are *individuals* capable of improvement, but the best of us always fall short of the standard. One dimension of our finiteness appears in our very inability to observe, relate, analyze, and effect events and our own actions in perfect fashion. The result we achieve often is not the result we will. We predict poorly. We comprehend history selectively and imperfectly. We decipher the ineluctable moral order and natural law of our existence in a substandard manner. Thus, we may crave juridical certainty but our fallible nature impedes us from perfect achievement and our whimsical cockiness warrants that perverse and unintended repercussions will occur. Those who seek predictability at the expense of personal liberty end up enslaved to the feeblest of minds and the most inferior mode of behavior.

V. A Demonstrable and Pervasive Deterioration

The dubious may seek proof that legal predictability is declining. Evidence abounds. The loss of certainty pervades every jural nook and cranny. A few select examples will demonstrate the point.

First, consider the law of contracts, that body of rules and orders which concerns the enforcement of promissory obligations. Perhaps in the dim and distant common law past all promises uttered were subject to strict enforcement: After all, the literalists of pre-Norman times burned fallen trees and slaughtered cattle if these inanimate objects or animals caused a human death. In any event, the Chancellor soon ameliorated the harshness of strict enforcement where, e.g., promises were induced by fraud, duress, or overreaching. Certainly, one ought not be held bound to perform an act which is the product of compulsion or deceit.

The history of the common law of promissory obligations makes one point patent: The law has slowly but surely evolved to an ameliorative stance wherein a promisor whose expectations are thwarted or whose forecast is flawed stands a likelihood of relief from his obligations, in whole or in part, at the expense of a promisee who forecasts more correctly and who now experiences punishment (in the form of *his* thwarted expectations) for accuracy. The Chancellor's Romanist/Continental influence provided the seed of many of these doctrinal devices—e.g., unilateral or mutual mistake, impossibility, commercial frustration—and modern legislators have carried on the tradition, e.g., the doctrine of commercial unreasonableness and other "public policy" pretenses. The result: Parties to a contract do not know if, and to what extent, the courts will enforce their voluntary bargain.

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"The predictable past has become the uncertain present, particularly with regard to the employment and enjoyment of real property."

Crumbling certainty damns the ethical promisor to an uneasy reliance; it permits the less scrupulous to enter silly deals with the glib assumption that, if all else fails, the legal system will bail him out. Consequently, parties make less efficient use of time, energy, ideas, and materials, and employ limited resources less carefully. In Japan, commercial transactions are never really "final" in the Anglo-American sense; solemnly written contracts are constantly "renegotiated" as times, conditions, and knowledge advance; the American scene more and more resembles its Oriental counterpart in this regard.[5]

Second, the law of real property affords additional proof. Over the centuries, real property rules and orders concentrated upon the law of titles and the devolution and transfer of land, with little or no heed paid to the *use* of property. While all titles emanated from the sovereign in jural folklore, the owner assumed that he could use his land as he saw fit. If, in some rare instance, his use of realty harmed a neighbor (e.g., escaping waters or wild beasts or the like), the law courts provided a forum and a recourse whereby a judge and jury could sort out the problem without any broad impediments of prior restraint. In the area of common law concentration—titles and transfer—a few fairly well-defined and formal rules developed over time, providing a known and certain framework for the maintenance and devolution of the principal form of wealth in Medieval England and, indeed, in Colonial and post-Revolutionary America.

The predictable past has become the uncertain present, particularly with regard to the employment and enjoyment of real property. Sovereign ownership of all land constituted a noxious and unnecessary fiction; nonetheless, in most instances until recently, indulgence in this fictive conjecture brought forth precious little practical harm: The laws of nuisance, negligence, and ultrahazardous activity, while containing an embryo capable of destroying the moral private property order, were reined in by judicious judges and common sense, leaving an owner in "fee simple absolute"[6] relatively unhindered as he sought the best use of his land in his subjective sight.[7]

Today, one cares little about titles, transfers, and competing private ownership rights.[8] Instead, the landowner fears the shifting sands of *public* claims upon his private real property, by virtue of land use regulation, direct condemnation for all manner of newly minted "public purposes," zoning rules and restrictions, inverse condemnation, and a covey of their legal siblings. Even more vexing is the fact that a landowner may buy real property for use in a particular manner and for a specific purpose lawful at the time of purchase, invest substantial sums in planning and improvements, only to discover to his horror and detriment that some public (busy)body with neither investment nor good sense (nor "right" in any acceptable sense of the word) has declared that the owner's specific piece of property may not be used for his desired purpose and, sometimes, for *no* reasonable purpose whatsoever.

Terminology makes no difference: In various jurisdictions the effective body may be known as a county commission, a city council, a land development bureau, a community planning organization, a neighborhood association, a design review committee, or one of myriad other designations. The end result does not vary: unpredictable and devastating interference with private property rights, underlain by the type of legal uncertainty that breeds frustration and political fixes.

Third, a review of the law of employment relations reveals additional stark uncertainty. The market flourished and all participants prospered precisely because entrepreneurs remained at liberty to deploy labor and capital in rapid response to the changing demands of the consumer. Planning resulted from voluntary action imposed upon individual assessment and analysis; those who forecast most accurately gained

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the greatest success, since they were the creators and suppliers of the most desired goods, services, and ideas. Contract, not coercion, regulated the market for labor as well as the supply of capital and the sale of products. In order to redeploy swiftly in response to market command, employers and employees often eschewed restrictive or lengthy workplace contracts: The dissatisfied workman could pull up stakes at will, just as the owner or the manager could sever the employment relationship at the end of its term.

Today, the law has skewed the workplace relationship in both an unfair[9] and an unpredictable fashion. Rules proscribing all manner of discrimination and discharge, even in the face of contrary voluntary contractual bargains, impose an unpredictability beyond measure upon the market. Some contend that American labor has priced the United States out of world markets; perhaps so, but more saliently, fewer and fewer enterprising and innovative entrepreneurs display any willingness to assume risks in an arena fraught with wholly unprecedented snares. For example, once an employee enters into a work relationship, the employer may be legally bound to feed, house, insure, and support him for the rest of his days, no matter how clumsy or inept, or how dangerous and distasteful, or how unproductive or hindering he may become. The "right to a (or this) job" slogan is fast becoming a political and economic reality.

Moreover, the employer's choice in the initial hiring process recedes almost as rapidly. George Roche described a "balancing act"[10] in academia a short time past; legislators and jurists have brought their act to the once-private market. In many jurisdictions and endeavors, the purchasers of services (owner, employer, manager) may not choose the best and the brightest: The invasive state tells him whom he shall employ and under what terms and circumstances—perhaps for a lifetime.

Government edicts do not consider quality, or the reciprocal right of the buyer of labor to his contractual rights: Instead, these norms look to a fictive balance of singular factors, e.g., age, race, religion, gender, sexuality, political persuasion, and the like. Given the expanding universe of "employee rights" in the areas of discrimination, discharge, work conditions, and benefits, to name but a few, no one can predict the cost of an enterprise with any assurance. One sure result: withdrawal of capital (goods, innovation, incentive) from the labor-intensive sector of the market, or a transfer from the capital market to the consumptive process entirely. Such market dislocations ultimately harm all participants; oddly enough, the greatest harm visits the very "classes" sought to be protected, aided, or encouraged.

Examination of every crack and crevice in the juridical structure reveals the rot of an enveloping unpredictability. Successive Congresses and legislatures create and tinker with ever-more-complicated rules and regulations, creating ever-changing codified "rights" of action and correlative prohibitions in verdant fields long void of coercive control. Legislation governing "hazardous waste" and other "environmental" conditions and uses, the trade and transfer of securities, the entry into any number of professions and enterprises, and all manner of business practices and combinations illustrates the point. The proliferation of revenue laws, especially in the disguise of "tax reform" producing a volume equivalent in size to the Manhattan Telephone Directory, further complicates the life of the ordinary citizen. The quantum extensions of liability in the several commonplace fields of tort or civil wrongs perplex the employer, producer, and national creative genius and increase litigation to the point of critical mass.[11] Substitution of wavering and often whimsical orders for known principles of choice-of-law where the rules of two or more jurisdictions come into real or apparent conflict[12] further befuddle one who tries to plan his life with any measure of good sense and foresight. Even the rules of evidence and proof shift subtly, unsettling the litigant who founded his case or defense upon the once-predictable past.

VI. Legal Unpredictability: Cause and Effect

Earlier sections of this essay have identified several causes of the developing uncertainty which plagues the United States. The pre-eminent causal factors merit reiteration.

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First, we have gradually but inexorably strayed from our common law roots. We have adopted the most inefficacious features of the Continental system—codes of prior restraint, invasive bureaucracies, mandate states—concurrent with a loss of the refuge of natural individual rights. Thus, we have discarded a belief both in the natural rights of each individual and in a natural universal law against which all positive law ought to be measured. As we blithely ignore our tradition, our conditions more and more resemble those unpleasant and unproductive hovels and multitudes from whence our ancestors escaped.

Second, the specific aspect of this first and overriding reason resides in our finite human nature. It is all very well to blame the Instrumentalists, but charlatans have seduced men and women for countless centuries: Unfortunately, the ideological brigand appeals to the fallible and sinister attribute in each of us.We do crave certainty— a secure and pleasant life where all of our choices produce desirable and fulfilling results. The statist panders to our inherent deficiencies by sweetly assuring us that perfect certainty and absolute predictability is possible, if only we cede the power to plan and regulate to the all-wise codifier. Walt Kelly's Pogo wisely announced "we have met the enemy, and they is us"; few twentieth-century sages have uttered any greater truth.

One would be remiss to ignore a third causal factor, bred by the general and specific features set forth: Unpredictability breeds further unpredictability as ensuing legislators, jurists, and administrators attempt to right patent wrongs created by the faulty constraints concocted by their predecessors. When planning is consigned to the political process, the bad judgments of the lower level creatures who occupy the seats of power become magnified and encrusted upon a society and an economy which ought to be mobile and reactive to the changing desires and the improving fund of knowledge of its inhabitants. Few of us readily admit error or failure; the legislator who creates a flawed program partakes of this human trait; hence, legislators tend to make similar and increasingly foolish choices as the world they try to manage unravels. Last year's assembly could not bind the present batch of lawmakers;[13] as a result, the content of the law and the rules of procedure vary, often drastically, leaving a confused and frustrated citizenry in its wake.

"Creative, innovative, and adventurous actions spice life and lift the individual from the doldrums, at the same time occasioning the material and mental wealth of the world."

In like fashion, this paper has elucidated some of the many adverse effects of increased uncertainty in the legal fabric. Again, a summary may place the issue in focus.

In the first place, mankind encounters less difficulty in dealing with the vicissitudes of the natural order than it does with the amorphous mass created by unpredictable human beings. Man must plan and attempt to predict; since he lives in a regular, not random, world, and since he possesses the equipment and acuity to grasp relationships, he enjoys the ability to adapt and adjust to the natural order, albeit imperfectly. By virtue of the complex matrix created when fallible men attempt to order human life and action, the world becomes more random and human endeavor becomes less predictable.

In the second place, economic success depends upon accurate prediction. Since all value is subjective, the successful producer creates and distributes the goods, services, and ideas most desired in the marketplace. Satisfaction of consumer demand requires the supplier to assess those desires, an assessment which requires certainty and regularity in order to avoid mere fortuity. Thus, to the extent that the law renders the legal or permissible results of human activity uncertain, economic efficiency declines into misapplication of scarce resources to satisfy nonexistent or less pressing human wants.

In the third place, unnecessary interference with human activity and needless uncertainty creates significant human unhappiness and anxiety. Creative, innovative, and adventurous ac-

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tions spice life and lift the individual from the doldrums, at the same time occasioning the material and mental wealth of the world. Useless dampers on such creative action not only impede personal and societal growth but also cause that mold of frustration which breeds in unnatural cultures. Litigiousness, instability, incivility, shoddiness, sharp practice, dishonesty, and their unpleasant companions become natural sojourners in the mandate state.

VII. A Plea for a Return to the Common Law Tradition

Mankind seeks the holy grail of a predictable world. As with the Crusaders' quest, a perfect solution eludes us. Nonetheless, we ought not give up this grand enterprise as futile; rather, we ought to adjust our legal system so as to permit each of us to seek this destiny and, to the extent of our paltry powers, to achieve it.

I plead not for our return to halcyon days of yore, to a Golden Age achieved and lost. Neither Golden Age nor shining city on the hill ever existed, save in our deepest dreams. Nevertheless, our English forebears understood the rudiments of a legal system which, if properly comprehended and carefully shielded from the dark improprieties of men, could once again serve as the jural landscape for a free, productive, and orderly society. That system—the common law tradition, founded upon a recognition that natural rights inhere in each of us, that all positive law ought to relate consistently to the natural order of things, that no fallible lawgiver ought to be cloaked with a codifying power of prior restraint, that a community system of justice exceeds professional dispute resolution in merit and fairness—proved worthy in the past. In its heyday, the common law provided the foundation for the most exciting and beneficial creativity in recorded history; it also coincided with the most mighty political revolution of all time, when these fragile states in a new world broke away from the barriers of the dull and tasteless past, from a system where tyrants sought to impose absolute certainty and could only achieve stale nonsense, and created a new legal system of freedom resting upon the finest attributes of the past.

The choice is clear: recapture the dream of a free and orderly society governed by a common system of law restricted to its proper bounds, or sink in the mire which continues to impoverish the vast majority of human beings in this world. □

1. For a further analysis of the faults of prior restraint, see Ridgway K. Foley, Jr., "Prior Restraint," 31 *Freeman* (No. 10) 609-614 (October, 1981).

2. Of necessity, this commentary upon the Instrumentalist Revolution is cursory. The subject deserves a deeper treatment; it is not relevant to the more limited point of this essay.

3. For an exploration into the labyrinth of modernism in the choice-of-law milieu, see Ridgway K. Foley, Jr., "Fragmentation in the Conflict of Laws," 47 *Or. L. Rev.* 377-389 (June 1968).

4. A respectable body of thought purveys the wisdom that decision-makers follow the robes, the scholars, and the communicators of the preceding era. In such an analysis, the revolutionary seeks to put forth his ideas in such a form so as to influence the clergy, the press and publishing houses, the wire and visual communications industry, the teachers, the scholars, the writers, and the judiciary. It would serve no useful purpose to deflect this paper from its intended course so as to consider this subordinate proposition. Nonetheless, in passing, I challenge both its veracity and utility, and suggest that ingrained human traits may not be so easily maneuvered or eradicated.

5. Sports fans and movie buffs will notice the constant "renegotiation" of agreements by players, coaches, managers, and the like. This unfortunate phenomenon extends well beyond the habitat of the athlete and the starlet.

6. This is the legal signification of the greatest "bundle of rights" one could own in real property in the common law system.

7. The state power of eminent domain also posed a threat to absolute ownership. In the United States, the Fifth Amendment guarantees of just compensation and a taking for a public use, coupled with the concept of a limited government, provided considerable protection to the private owner.

8. But, consider the unpredictability of the modern law of creditors' rights, where legislators protect favored classes of debtors at whim and will.

9. This essay delves into the decline of certainty; it remains for another day to discuss the imbalance and deleterious effects created in the marketplace by, e.g., Employer Liability Laws, Workers' Compensation Acts, mandatory unionism and the closed shop, affirmative action, and like programs.

10. George Charles Roche III, *The Balancing Act* (La Salle, Illinois: Open Court, 1974).

11. See Ridgway K. Foley, Jr., "The Liability Crisis," 37 *Freeman* (No. 1) 12-27 (January 1987).

12. Note 3, *op. cit.*

13. The Founding Fathers created a United States governed by a written Constitution, designed to eliminate whims of politicians and winds of change. Today, the constitutional limits upon governmental action are greatly attenuated; indeed, the deterioration of predictability seeps into the interstices of our governing document, as individual rights once certain become quite ephemeral and dubious.

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Who Is an American?

by Richard R. Mayer

As Americans we are often un-American when it comes to illegal aliens.

The word "illegal" connotes something contrary to the law; yet what more clearly defines our law than those unalienable rights spelled out in the Declaration of Independence or what better describes our land than its heritage as a haven for those wishing to better themselves? Can we logically describe as "alien" those who seek freedom, opportunity, and equality before the law?

America is a unique concept. It is a land whose people are defined not in terms of nationality but of outlook. It is what one believes that makes an American, not skin color, religion, or language.

An American is described by his beliefs, his adherence to certain clear principles not of religion but of religious freedom, not of status but of equality of treatment, not of privilege but of opportunity. By this measure there are many true Americans who do not reside here, and others who vegetate here but are not truly Americans.

There is concern that those who come to this land may take jobs from local residents, secure false social security cards, passports, and drivers' licenses, or go on welfare. But are such regimentation and programs really the American heritage? And is beating someone out of a job by being more willing and competitive really un-American? Such objections come from those who have obtained privileged or protected positions through licensing, certification, seniority, or monopolization and who are not willing to compete in a free and open market.

Do I, because I was born here, have greater claim than one who has made the conscious choice to come to the United States? Do I through mere chance and by none of my own doing have a greater claim to being an American than he who has made the effort?

I think not. I only am an American by being an American, by making that choice daily in my life. And the refugee who makes that choice is also a true American, as much as I—a brother of the spirit, as Americanism is a matter of the spirit. He has the right to live, to provide for himself, and to care for his family, without certificate of occupancy or let from petty official or regulatory agency.

Through our churches and legislatures, we dole out billions of dollars in foreign aid—anything to keep the natives happy (and away from our shores). We charitably give to others, so long as they'll stay where they "belong." But we will not grant them the right to practice Americanism, claiming this as a privilege for those who got here first. This isn't very American. □

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Tear Down This Wall

by Russell Shannon

Last June, after his conference at Venice with the leaders of Japan, Canada, and Western Europe, President Reagan made a brief but significant visit to Berlin. There, in front of the Brandenburg Gate, he issued a striking and much-publicized challenge to the Soviet leader, Mikhail Gorbachev.

The Berlin Wall has stood for two and one-half decades as a symbol of repression by both the East European countries and the Soviet Union. Driven to digging tunnels and making other desperate attempts, people held behind the wall have sought to break through to gain the freedom and opportunities enjoyed in the West. In the process, some have perished.

The border between Eastern and Western Europe has not always been sealed. Now, at a time when the Soviet leader is preaching a policy of "glasnost" (openness), President Reagan urged him to take a dramatic step beyond talk to action. As a sign that he really means what he says about expanding freedom, President Reagan urged:

"Mr. Gorbachev, tear down this wall."

Yet less than one month after the President's proclamation, a terrifying event revealed that Soviet Russia and its satellites have no monopoly on border problems. Not far from El Paso, Texas, a railroad car was opened to disclose the bodies of 18 Mexicans who had perished in a desperate attempt to cross the Mexican border into the United States.

The border between Mexico and the U.S. has not always been sealed. Until about a century ago, we welcomed people from other lands. No walls had been erected and so no one stood guard at our gates to check entry visas. Immigrants came in great numbers, some escaping political tyranny and religious repression, others responding to the promise of economic opportunity.

Indeed, according to Oxford University professor John Gray, in the century prior to World War I, not only in the United States but throughout Europe, "Everyone believed that free migration promoted prosperity. Statesmen took for granted that the freedom to travel was part of the market economy." Classical economists argued that, "Just as tariffs and quotas resulted only in dislocating the world market and decreasing economic welfare, so too immigration controls resulted in economic stagnation and the waste of human resources." (*The Wall Street Journal,* June 1, 1983)

Yet, toward the end of the last century, attitudes changed. We began to impose restrictions, first limiting the entry of Orientals, then others. By now we have a rather rigid system designed to control both the numbers and types of people entering the country. Although legislation passed by Congress in 1986 granted amnesty to many who were living here illegally, it also imposed new constraints on employers in an effort to make further immigration less attractive.

During the summer of 1987, numerous reports from the northwestern states revealed that crops of fresh fruits and vegetables were in danger of rotting for lack of labor to harvest them. Why do we deny entry to willing laborers when there is so clearly much work to be done?

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Traffic coming into Laredo, Texas from Mexico must pass through the U.S. Customs checkpoint where citizenship papers or documents for passage are presented.

Consider the following points:

• In general, immigrants do not become a burden to taxpayers. In fact, economist Julian Simon has shown that immigrants tend to be net contributors to government revenues, rather than a net drain. Often young and vigorous, they frequently pay income and social security taxes for many years, only to return to their homelands before receiving their full benefits. (*The Freeman,* January 1986)

• While it may be true that in some instances immigrants take jobs away from people who were born in the United States, there is also much evidence that Americans often don't want the jobs immigrants take.

• If working conditions for immigrants are frequently below our standards, the fact that immigrants have come here voluntarily at often great risk to themselves suggests that the opportunities they find here are at least superior to those they left at home.

• What's more, when the immigrants spend their incomes to buy food, clothing, and shelter, they provide additional jobs for people already here—an application of the famous old economic principle known as Say's Law: "Supply creates its own demand."

• In recent years, much concern has been expressed about the so-called "deindustrialization" of America. Whether the facts support these fears or not, the influx of workers willing to take jobs at low pay helps to discourage American producers from setting up shop outside our borders to cut labor costs. And for the rest of us, their work keeps the cost of products down and helps to improve our standard of living.

When people such as the Mexicans are dying in their efforts to break through the barricades and enter the U.S., just as others have died attempting to breach the barriers surrounding Eastern Europe, some extremely troubling questions demand answers: Do we have legitimate economic, moral, and political grounds for denying immigrants access to the freedoms and opportunities which we enjoy in such abundance? Can we justly deny to others what once was offered to our ancestors? Can we criticize the restrictive emigration policies of the Soviet Union and its Eastern European neighbors when we engage in restrictive immigration policies?

In view of these concerns, would it not now be most appropriate for the President to follow up his dramatic challenge in Berlin by journeying to Brownsville, Texas, and San Diego and, regarding our own unwarranted barriers to the free movement of the world's peoples, say:

"Members of Congress, tear down this wall." □

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Yugoslavia: Trouble in the Halfway House

by Melvin D. Barger

What's wrong in Yugoslavia?

The news reports out of Belgrade speak of a troubled country with a stagnating economy, ruinous inflation, out-of-control foreign debt, rebellious workers, and a defiant citizenry. These problems would be ominous in any country, but they are especially so in Yugoslavia. One fear is that mounting troubles could force Yugoslavia back into the tight Soviet orbit it escaped in 1948. There are also worries of exacerbating tensions among the different national groups in the Yugoslav federation. Another fear is that Yugoslavia—whose individual countries helped create the term "Balkanize"—could simply unravel as a unified nation.

Yugoslavia's current problems are surprising because the country has been a showcase for "workers' self-management." The country's troubles must be disappointing many intellectuals in the U.S. who wanted to believe Yugoslavia had created a golden "halfway house" between capitalism and Communism. Yugoslavia was supposedly proving that there can be a "market socialism." But the dream is becoming a nightmare. Once seen as an exciting wave of the future, this hybrid socialism has fallen on hard times. And workers' self-management, the vaunted "third way," may be much of the problem.

Some believe that Yugoslavia's centuries-old religious and ethnic rivalries add to its troubles. The country also suffers from the same ills that threaten many mixed economies, including our own. Yugoslavia's major problems include excessive public spending and a system that hampers the market and distorts capital investments. Its policies encourage excessive consumption and the maintenance of inefficient industries. Its decentralization, a good thing under some conditions, has divided the country into protectionist enclaves. At the same time, despite its decentralization, Yugoslavia is also a Communist country, still infected with the flawed vision of Marx and Lenin.

One of the tragic outcomes of World War II was the Communization of Eastern Europe into what became known as the Soviet bloc. Yugoslavia, organized as a Communist state in 1945, seemed particularly menacing with its 300,000-man army and aggressive leadership under Marshal Josip Broz Tito. Though badly crippled by the war, this new Communist state appeared to be a dagger poised for future attack on its neighbors.

Break Led to New Course

Three years later, however, the shocking break between Tito and Stalin set Yugoslavia on a new course. It remained Communist in name and government, but it adopted the new economic policy which came to be called "workers' self-management." Restrictions were gradually relaxed in practice, and thousands of people left the country with the government's blessing to become guest workers in West Germany and other prospering countries. Industrial output climbed. Belgrade became a modern city with large department stores, traffic jams, and towering office buildings. Though large-scale private ownership was still

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banned, workers' self-management gave managers considerable latitude in business negotiations. Much of the country's agriculture continued to be in private hands, and a thriving private enterprise sector developed under special provisions which were variants of Communist doctrine.

Tito, a harsh Communist with amazing luck and cunning, became a Yugoslav folk hero, although not to everybody. Years after his death, he is still hated by dissident Serbians and other Yugoslavs who believe leftist influences in the British and American governments tilted support his way during World War II. This helped put Yugoslavia in the Communist camp while dooming another wartime resistance leader, General Draja Mihailovic (executed by the Communists in 1946). In the West, Tito received a consistently favorable press, and he was considered so indispensable that many feared the country would fall apart following his death. He did have the political skills to form a government representing the various Yugoslav republics, something that had been lacking in the Serbian-controlled monarchy which headed Yugoslavia following its formation in 1918. Tito died in 1980, but it's doubtful that his death had much to do with Yugoslavia's current troubles.

Workers' Self-Management

Milovan Djilas, the former Tito associate who became an outspoken critic of the Communist system, claims credit for the adoption of workers' self-management in the country. According to his recollections, he made the proposal in the spring of 1950, some months after the break with the Soviet Union. It occurred to him, he said, that Yugoslavia was now in a position to "start creating Marx's free association of producers." He explained the proposal to two other associates in the Tito circle, Boris Kidric and Edvard Kardelj. Winning support of other leaders, Djilas and Kardelj finally took to Tito the idea of introducing a workers' council bill in the parliament. They pressed him hard because they believed it was an important step, Djilas recalled. He wrote, "The most important part of our case was that this would be the beginning of a democracy, something that socialism had not yet achieved; further, it could be plainly seen by the world and the international workers' movement as a radical departure from Stalinism. Tito paced up and down, as though completely wrapped up in his own thoughts. Suddenly he stopped and explained: 'Factories belonging to the workers—something that has never yet been achieved!' A few months later, Tito explained the Workers' Self-Management Bill to the National Assembly."[1]

The main feature of Yugoslavian self-management is that of control of each enterprise by a representative body called the workers' council. The idea was not new, and in Russia it had been tried after the 1917 revolution. But in the Soviet Union, central direction of economic affairs soon replaced economic decision-making by the councils. In Yugoslavia, on the other hand, the councils were constitutionally empowered to *run* the various enterprises. Self-management was not limited to business and industry, but was also applied to service bodies such as the post office, railways, telephone service and, to a certain extent, universities and similar organizations.

There was also a provision for private enterprise if no more than five were employed in the individual activity. Most of the privately-owned and operated businesses emerged in such fields as construction, personal services, restaurants, trucking, and farming.

There were several reasons why the new plan made good politics for Tito and his group. For one thing, they continued to be Communists and, thanks to Djilas' reasoning, workers' self-management could be defended as sound Marxist doctrine. They were also disillusioned by what they called the "bureaucratic collectivism" which was choking off economic growth in the Soviet Union. Beyond that, the decentralized nature of self-management made political sense because of the severe rivalries and jealousies among the Yugoslav republics.

Not Really a Single Nation

Central control is an explosive issue in Yugoslavia in view of its ethnic and regional diversity. Yugoslavia actually means "Land of the South Slavs," but it goes back only to 1918 as a unified country and has had its present

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name only since 1929.[2] The present ethnic makeup of Yugoslavia's 23 million people is 36 per cent Serbian and 20 per cent Croatian with the rest being comprised of Bosnians, Slovenians, Macedonians, Albanians, and a few other national groups. One of the persistent jokes is that Tito was the only Yugoslav, all others stubbornly retaining their ethnic identities! The fear of Serbian domination also persists in Yugoslavia, where Belgrade is the capital of Serbia as well as of the federation.

In the beginning, self-management and relaxed controls seemed to produce economic wonders in Yugoslavia. This may have led observers to think that the Yugoslavs had found the miraculous formula that would blend the dynamism of capitalism with the supposed democracy of socialism. Self-management seemed to work so well for a time that its contradictions and problems went unnoticed.

Actually, there were good reasons why Yugoslavia could expect substantial growth once the bureaucratic fetters were removed from its basic enterprises. The country had expectations of comparative advantages in many fields: mining, shipbuilding, heavy manufacturing, agricultural products, tourism, chemical fertilizers, and knitted and leather clothing. It had an energetic labor force, good seaports, and access to European trading partners who were soon to have spectacular growth.

Growth and Then Trouble

The 1960s and early 1970s seemed to be bright years for Yugoslavia. The country's exports surged to exceed $10 billion, two-thirds of this amount to countries outside the Communist bloc. Many of Yugoslavia's industries seemed highly competitive in world markets, and there were even astonishing reports that efficient Yugoslav shipbuilders wrested contracts away from the Japanese. Visiting a construction equipment manufacturing firm in the U.S., one might meet teams of earnest, friendly Yugoslavs who had come to study new equipment methods. And since Yugoslavia itself is a tourist's paradise, thousands of visitors from the West came to enjoy the country's beaches and mountains.

All this seeming prosperity masked some serious problems. For one thing, Yugoslavia's debt was becoming unmanageable. Despite growth, the country could not create sufficient jobs for its own population, a main reason why the government was willing to permit 600,000 people to become guest workers in other countries. The individual enterprises also were not financing their own growth, and most of the capital spending came from money borrowed outside the country. It was also true that much productivity came from small, privately owned businesses which had to operate very discreetly in order to survive under the watchful eyes of bureaucrats who still gave allegiance to Communist doctrine.

By the 1980s, stories about Yugoslavia were beginning to include terms like "crisis" and "economic troubles." The Olympic Winter Games of 1984 focused attention on Yugoslavia, but also "masked" the country's problems, according to *U.S. News & World Report*. This article mentioned an inflation rate of 50 per cent, public unrest leading to strikes, a crippling national debt of $19 billion (now a billion higher!), 15 per cent unemployment, and shortages of basic food supplies and even gasoline.[3] The problems continue to intensify.

Usus Fructus

Some observers attribute Yugoslavia's troubles to "high living" and the indifference of workers. It would be more helpful to study the system—and particularly "workers' self-management," since it controls the performance of the major enterprises. It is becoming painfully clear that self-management looks good only in comparison with harsh centralist economies. In competition with privately owned enterprises in the world marketplace, it is beginning to stumble badly. For one thing—despite Tito's glowing statement—it is not worker ownership. Professors Erik G. Furubotn and Svetozar Pejovich concluded that the accurate term to apply to the workers' claims in these enterprises was *usus fructus*. In American legal terminology, *usus fructus* is the right of use without ownership, as when a person is given the full use of a company automobile or some facility. They pointed out that the crucial distinction between full ownership and *usus*

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fructus carries behavioral implications which were not recognized by Yugoslav economists.[4]

These "behavioral implications" were predictable. The economists believed workers in control of enterprises would attempt to gain higher incomes (for themselves) through the strategy of reinvestment in the firm. As it turned out, however, workers shunned this type of long-term thinking because there was little immediate gain to them from increasing the value of the firm's assets (they cannot buy and sell shares, as in a stock market). Their investments were channeled to things that were most likely to benefit them directly. Not surprisingly, many of these investments amount to current consumption at the expense of future productivity. When workers run the show, Barry Newman noted in *The Wall Street Journal* (March 25, 1987), the one thing they don't do is invest their profits. "They do award themselves fat raises. Then they borrow. And when debt ruins the economy, inflation tops 85% and their buying power collapses—they strike."

True "ownership" by workers would provide more incentive for real reinvestment—but this is blocked by socialist doctrine. And even if workers were more devoted to reinvestment in the enterprise, one wonders how many council groups have the competency to make shrewd and productive decisions. In U.S. companies, even highly trained managers frequently make bad capital spending choices which they regret later.

Another appalling problem in Yugoslavia is protectionism practiced by the various republics. Though decentralization is supposedly an advantage, it becomes a liability when each republic jealously guards its own turf in ways that bring about irrational and costly practices. According to a 1984 *New York Times* report, these rivalries are carried to such extremes that each republic has its own share of the railway network. A train has to switch engines every time it crosses republican borders, replacing, for example, a Slovenian engine with a Croatian one, and later with a Serbian one. Disputes over operation of the rail network were so intense, according to the article, that there was even a question whether there would be enough coal in Belgrade that winter—though coal production was up. Nothing moved while the republics argued over who would carry coal![5]

The same article also explained how politicized workers' management was keeping a nickel plant open and even expanding at a cost of millions of borrowed dollars while world nickel prices were plunging and big producers in Canada were shutting down. Similar decisions apparently have been made at other operations throughout Yugoslavia. These practices help explain why Yugoslavia has worked itself into a deep debt position which now threatens to topple the economy.

Writing in *The Wall Street Journal* (October 12, 1983), Nora Beloff explained how this had happened. "Jollied along by affluent Western banks eager to lend, and by underutilized Western industry eager to sell, Yugoslavia's ruling elite went on a spending binge, defying the advice of the country's best economists, who warned that loans on this scale could never be repaid." According to Beloff, these massive loans were raised by influential local political bosses in Yugoslavia who were keen to install big plants in their own territories. "None had the smallest concept of cost-effectiveness, nor did they consider themselves personally responsible for repayments." The loans all went for construction of large ventures like steel mills and aluminum smelters, and by the time the plants came on stream there were no funds left for working capital. So Yugoslav enterprises even depend on credit for almost all their operating costs.

Yugoslav news also gives the impression that the work pace has slowed in many industries. A report by Andrew Borowiec in *The Washington Times* (October 23, 1984) carried the ironic comment that much of a Yugoslav worker's time is spent discussing productivity. He described the situation in a shipyard employing close to 6,000 workers: "The shipyard has 672 self-management and socio-political units," Borowiec wrote. "These units hold 11,525 meetings a year for a total of 31,911 hours. In terms of production, . . . it represents one small tanker."

This management-by-committee slows decision-making as well as production. Borowiec quoted a British businessman he interviewed in a Belgrade hotel: "The whole thing is mad-

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dening. These people take six months to make a decision that requires at the most one hour.''

Mises on Guild Socialism

Yugoslavia's troubles may be a surprise to many who had high hopes for workers' self-management. It's no surprise to students of free-market economics. The concept of workers' self-management is really a variant of ''guild socialism'' which Ludwig von Mises examined in his classic work, *Socialism*. One self-deception of guild socialism, Mises explained, was the belief that it could create a socialist order of society which would not endanger the freedom of the individual and would avoid all those evils of centralized socialism which the English detest as Prussianism. But it would be necessary for the state to set the aim of production and what must be done to achieve this aim, Mises noted. This central control was necessary if the system were to work at all. ''Society cannot leave it to the workers themselves in individual branches of production to determine the amount and the quality of the labour they perform and how the material means of production thereby involved shall be applied,'' Mises said. ''If the workers of a guild work less zealously or use the means of production wastefully, this is a matter which concerns not only them but the whole society. The State entrusted with the direction of production cannot therefore refrain from occupying itself with the internal affairs of the guild.''[6] Mises also doubted that the workers under guild socialism would perform efficiently under their supervisors or would know what to produce and in what amounts.

Workers' self-management in Yugoslavia seems to be a species of guild socialism, and it is apparently displaying the same contradictions and shortcomings that Mises thought would make this form of socialism unworkable. The central government in Yugoslavia has taken a number of steps to adjust to workers' self-management, but these actions only delay the solution and deepen the damage. The high double-digit inflation, for example, is the result of frantic efforts to meet impossible demands on the budget. At some point, there must be a breakdown when the currency becomes virtually worthless, when lenders will no longer be able to accept Yugoslavian debt, and when worker alienation almost paralyzes the economy.

When that happens, it's highly probable that some intellectuals will conclude that workers are too ignorant, too lazy, and too selfish to manage their own operations. The real problem with workers' self-management is more fundamental to human nature: *We all become too ignorant, too lazy, and too selfish to manage operations when we are placed in arrangements that attempt to suspend or bypass the needed constraints of the market.* None of us knows what ought to be produced when we don't have the market as a guide. Few of us work as hard as we can if we don't have incentives for doing so. And we all usually make decisions with our own interests in mind.

Is There Life After Self-Management?

What's ahead for Yugoslavia when the current system collapses or becomes unworkable? The two choices that seem obvious are a return to some highly disciplined centralist control or a bold attempt to move toward a free-market economy. The crying need, of course, is for the latter.

One of the lessons of history is that an oppressive central Communist or Fascist government does have political appeal after a system drifts into anarchy and chaos. A strong leader or party promises to restore order and direction which many people crave after a period of turmoil and uncertainty. And for a time, the new system will seem to ''work'' because it eliminates opposition and stifles dissent. The Communist clique that heads Yugoslavia could impose such control on the country, but with great difficulties in view of trends elsewhere in the Communist world. The central government of Yugoslavia also must consider possible rebellion or resistance from the republics if tight central control is re-established.

A more exciting possibility is that Yugoslavia could eventually adopt essentially capitalist forms to replace the current self-managed enterprises. The barrier to this is Communist and socialist philosophy. But it's becoming

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clear that the lack of ownership status is the major defect of workers' self-management. Djilas has even suggested that workers ought to own shares in their companies. Professor Ljubo Sirc, a Slovenian who now teaches at the University of Glasgow, flatly asserts that what Yugoslavia needs is a market economy. Writing in *The Wall Street Journal* (August 10, 1983), he expressed grave doubts that any new loans or other *ad hoc* measures could solve Yugoslavia's problems without greater freedom for the self-managed enterprises.

There's also a need to break down the barriers that prevent cooperation among the various Yugoslav republics. But that will tend to happen easily and smoothly when the economic interventions are eliminated. If the railway network in Yugoslavia were under private ownership, for example, it would quickly discontinue the costly practice of switching engines when trains passed from one Yugoslav republic to another. There would be no way to keep inefficient factories in business with the elimination of subsidized borrowing through the government. Each enterprise would find its place in the world markets and survive according to its productivity and efficiency. Yugoslavian managers, now still restricted by the workers' councils, would have broader authority and accountability under a profit-driven system.

Socialist Myths

What about the dreams of "democracy in the workplace" and Marx's "free association of producers"? These are socialist myths which have led to foolish experiments and conclusions. We all benefit by being democratic in spirit and we should be free to associate with other producers. But the market will only reward us according to our abilities and it will also set the terms for our production. In a free-market economy, workers' self-management is always permissible when any group of workers wants to set up or buy a business to run themselves.

As we know from experiences here in the United States, however, worker-owned and operated enterprises have had only limited successes and have not proved either more efficient or more democratic than other businesses. There have recently been a number of employee buyouts of ailing enterprises and obsolete factories, and it's not surprising many of them continue to fail. Even under the best of conditions, it's difficult and risky to run a business. It takes expert, alert, and energetic management to keep any business profitable and on the right track. And the frequent turnover of business executives in the U.S. shows that finding good managers is a difficult task even for the most successful enterprises.

Socialism, with its outmoded ideas about class struggle, has always praised the worker and scorned the managerial class. But workers and managers should actually be partners in the production process, not adversaries. There is nothing about being a worker that makes one worthier and more virtuous, and there's nothing about being a manager that should be discreditable. Both are needed in their proper roles. Many managers, in fact, are workers who later developed good managerial skills.

In its present form, workers' self-management in Yugoslavia is bad management, bad business, and even bad politics in the long run. With full property rights in business and a free-market economy, Yugoslavia could become one of Europe's most prosperous and productive countries. Let's hope that it works out that way. □

1. Milovan Djilas, *The Imperfect Society* (New York: Harcourt, Brace & World, 1969), pp. 219-222.
2. Its name between 1918 and 1929 was "Kingdom of Serbs, Croats and Slovenes."
3. *U.S. News & World Report*, February 6, 1984, p. 37.
4. Erik G. Furubotn and Svetozar Pejovich, "Property Rights, Economic Decentralization and the Evolution of the Yugoslav Firm," *The Journal of Law and Economics*, October, 1973, pp. 275-280.
5. Michael T. Kaufman, "Decentralized Decision-Making Plagues Yugoslav Economy," *The New York Times*, October 29, 1984.
6. Ludwig von Mises, *Socialism* (New Haven: Yale University Press, 1951), p. 261.

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Public Choice: The Rest of the Story

by Dwight R. Lee

Tibor Machan, in a recent article in *The Freeman* (September 1987), faulted public choice theory for ignoring the importance of ideas and ideological convictions in political behavior. Machan is correct in arguing that ideas and ideology are important influences on political decisions. He is wrong, however, in arguing that public choice theory needs to be modified to take these influences into account. The public choice model as it stands provides a coherent explanation of why, when making political choices, an individual's understanding of what is in the public interest is often more important than concern over his or her private interest, narrowly defined.

Lowering the Cost of Ideological Expression

It is true, as Machan points out, that public choice is rooted in the assumption that people are motivated by self-interest in both their market and political roles. This is admittedly a simplifying assumption, but it is the basis for the enormous analytical leverage economic theory in general, and public choice theory in particular, is able to apply to our understanding of social interaction. It should be pointed out, however, that the assumption of self-interest is not as restrictive as it is commonly made out to be.

It is undeniable that people value a wide range of things not normally thought of as economic goods and services. Among the noneconomic items that people value are their opinions and beliefs. Certainly nothing in public choice theory rules out the recognition that self-interested people may want to promote their vision of the good society.

Caution has to be exercised here, however. If we attempt to explain why people act on the basis of ideological considerations by simply putting an ideological variable in their utility function have we not, as Machan says, made "shambles of the explanatory value of the economic man model. Any . . . model that explains anything whatever . . . simply explains nothing much!" (p. 355) While this point is well taken, and does indeed indicate a risk, this risk is avoided by making sure that we go beyond simply explaining that people behave ideologically because they want to.

The public choice model does go beyond this obvious tautology by predicting that people will behave more in accordance with their ideological convictions when the cost of doing so is low than when the cost is high. This prediction is subject to rejection by empirical evidence and thus avoids Machan's methodological concern. It also forms the basis upon which public choice is able to provide an explanation for why self-interested people are more likely to make political choices on the basis of their view of the public interest than they are in making their market choices.

While individuals may place value on their personal beliefs, it does not follow that they will be prepared to make great sacrifices in order to promote those beliefs and put them into action. Some will, of course. History is full of examples of people who have endured great hardship, even death, in order to express and spread their beliefs. But most people are less dedicated and heroic. This does not mean that people will ignore their ideological preferences in the decisions they make. It does mean that people are more likely to let ideology influence their choices when making political decisions because the political process lowers the cost of ideological expression.

Consider an individual who feels that the general public would be better served by a reduction in government and is considering how

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to vote on a proposal that would increase his income but also expand government. Because of the ideological preference for the ideals of limited government, the individual will receive satisfaction from voting against the proposal.

But isn't the loss of income that will occur if the proposal is voted down a high personal price to pay for this satisfaction? The answer is "no" for the reason that no single vote is likely to determine the outcome. The probability is effectively zero that the individual's vote against the government program will break what otherwise would have been a tie vote and make the difference between the proposal's passing or losing. So it costs the individual essentially nothing to vote for his perception of the public interest (against government expansion) and against his financial interest because, with near certainty, the outcome will be the same no matter how he votes.

The costlessness of making ideological choices in the political process contrasts sharply with the cost of doing so in the marketplace. In the marketplace if an individual chooses a particular product the choice is decisive. The consumer gets the product he chooses and he gets it because he chose it. There is no hope of voting for a less preferred product for ideological reasons and still receiving the more preferred product. It is possible to express ideological preferences in the marketplace, but there is a real cost of doing so in terms of sacrificed alternatives.

We now have the basis for the public choice explanation of why ideological factors are more important in the political process than in the market process. The explanation in no way depends upon *ad hoc* assumptions that people are more concerned with the public interest when making political choices than when making market choices. People behave differently in a political setting than in a market setting, not because they bring different preferences into the two settings, but because the relative costs of alternative choices are different in the two settings.

This explains why Machan is half right and half wrong when he says: "If public servants were to become convinced that the promotion of some popular project is indeed *not a proper government activity* in the first place, then despite what they might do in circumstances which are not governed by this 'ideological' consideration, they could come to behave very differently from what public choice theory predicts." (p. 355, emphasis in original)

Machan is right to say that public servants will more likely behave differently when ideological considerations are present than when they are not. Machan is wrong, however, when he asserts that public choice fails to predict the difference in behavior. By failing to understand the public choice explanation for the importance of ideology in political decisions, Machan also fails to understand a powerful explanation as to why ideas do have consequences; in particular why ideas have political consequences.

Ideas have far-reaching consequences in all areas of human activity and they have consequences for a variety of reasons. But clearly an important reason why ideas have consequences in the political realm is provided by the public choice insight that in the political realm it costs people less to act in accordance with their ideas of what is right and proper. For this reason the battle over the proper role of government in our constitutional democracy is a crucial one. If we can once again engender a prevailing ideological commitment to the classical liberal ideal of limited government, this commitment is sure to translate into a government that is smaller and more effectively restrained than the one we have today.

Conclusion

Public choice, like any model of complex human behavior, is not the whole story. But it is more of the story than Professor Machan realizes. By subjecting the political process to rigorous analysis, public choice has been able to make a strong case for imposing strict limits on the size and scope of government. Furthermore, public choice provides a compelling explanation of why it is so important to make such a case. If the public choice understanding of government becomes generally accepted, then it will once again be possible for the people to control government instead of being controlled by government. □

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Are Credit Card Interest Rates Too High?

by Jorge Amador

Interest rates on home mortgages are hovering around 10 per cent and car loans are no longer unusual at 7 per cent, but most of us are still paying annual rates of 18 per cent or more on our unpaid credit card balance. Why?

"It's a ripoff," says Elgie Holstein of the Bankcard Holders of America.[1] There is a widespread feeling that banks are somehow taking advantage of credit card users. Illinois treasurer Jerome Cosentino has withdrawn some $2.2 billion in state funds from two Illinois banks in protest over rates close to 20 per cent.[2] Alan Fox of the Consumer Federation of America blames "credit card profiteers" for what he calls "irresponsible exploitation of credit card consumers."[3]

At least five bills have been introduced in the last two Congresses to clamp down on credit card interest. Last spring a subcommittee of the House Banking Committee approved a proposal to cap rates at 8 per cent above the yield of one-year treasury securities—setting the ceiling at 13.8 per cent using the rates then in effect.[4]

Richard Kessel, executive director of the New York State Consumer Protection Board, warns that interest-rate ceilings may have to return to bring card charges in line with other rates: "The fact is that . . . deregulation is not benefiting consumers when economic conditions clearly warrant a decrease in interest rates." He adds, "Deregulation is a good idea when it promotes competition, but in this case it has not. Financial institutions and retailers have not been motivated to lower their credit card interest rates."[5]

Jorge Amador has written for the Philadelphia Inquirer *and* Daily News, *the* Orange County Register, *and many other periodicals.*

Competition or Oligopoly?

"I think the answer is self-evident: there simply is a lack of competition in the credit card business," says Tennessee Senator Jim Sasser. "A relatively small number of very large card issuers keep these rates artificially high."[6]

In a statement before the Senate Banking Subcommittee on April 21, 1987, New York Congressman Charles Schumer declared, "In every other one of those [credit financing] areas there is genuine and real competition—the free market is working. In credit cards, we have oligopoly." Schumer theorizes that the credit card market is dominated by a few large issuers who exercise "price leadership" to hold the line at a high rate.[7]

How competitive is the credit card market? In 1986, Americans held 731 million credit cards from 15,000 issuers. The largest single issuer, Sears, accounted for 11 per cent of all credit card balances outstanding at the end of 1985.[8]

Citicorp, the largest bank card provider with 9 million,[9] had less than five per cent of the 186 million bank cards issued in 1986.[10] Together the ten largest issuers accounted for less than one-fifth of the bank credit cards issued to consumers.[11]

To be sure, no consumer has access to thousands of sources of credit in his geographical

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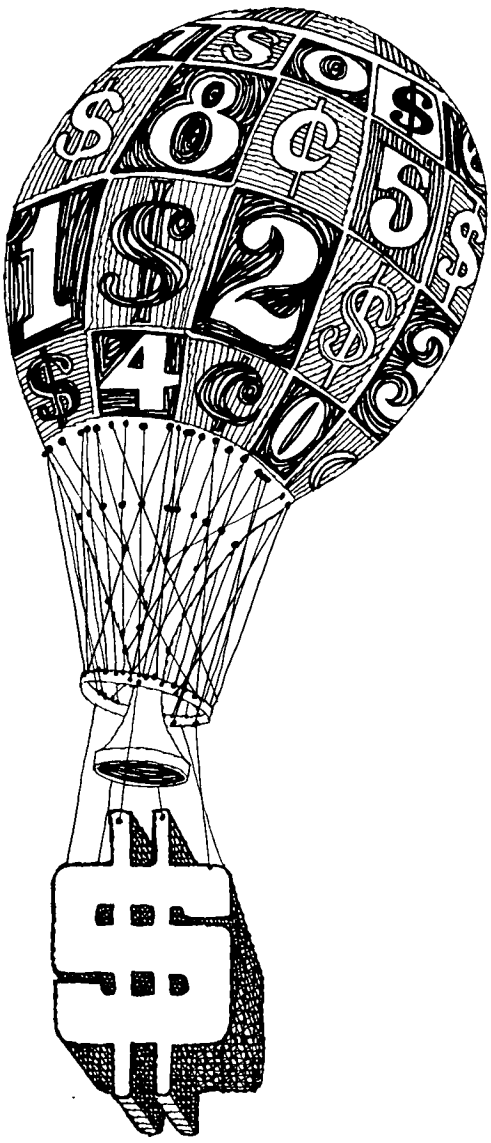

area. But credit cards are primarily a mail-order business. In principle any person could write to every issuer, apply for their cards, and shop for the best deals. Retailers may not be interested in giving cards to people who don't live near their outlets, but on the other hand some banks aggressively seek customers across the continent.

As Senator Phil Gramm of Texas observes, "I have access to the mails," and through them "I have access to credit cards. Is it not right that I have more access to more different sources of credit and general credit cards than I have access to grocery stores and to drugstores?" The consumer is limited to the grocers and drugstores in his area, but he isn't limited to the banks in his area.[12]

The rate of interest is only one of the elements of revolving credit plans that may be subject to competition among issuers. Credit card programs vary widely over such features as:

- *Annual card fees.* The fee charged for having a card ranges among issuers from none to $25 and higher. Sears offered a no-fee first year to attract applicants to its Discover card.
- *Transaction charges.* Cash advances made against the credit line (as opposed to card purchases) usually but not always incur a per-transaction fee, ranging from 50 cents to $1 to a percentage of the cash advance.
- *Length of the grace period.* The grace period or "float," the interim between the moment you charge your purchase and the moment interest begins to accrue, is typically 25 or 30 days. Some banks do not offer grace periods and charge interest on all purchases and cash advances made during the month.
- *Interest calculation method.* The grace period might begin at the time the bill is prepared; or it might start on the date a purchase is made or posted, which gives the customer less time to pay before interest begins to accrue.
- *Discounts and enhancements.* Citibank offers "Citidollars" on every purchase. These "dollars" can be traded in for discounts on merchandise bought through the issuers.

The First National Bank of Chicago offers special "First Card Checks." These notes are used like checks and serve as an emergency cash advance when a bank or electronic teller is unavailable.

Other credit card issuers have tried pre-approved credit lines, low-cost insurance, and rebates on purchases made with their cards. "Some creditors even prefer to compete with discounts on winter cruises than modest interest reductions," observes *The New York Times*.[13]

So, if card issuers are competing on all these fronts, and the market is truly so free, why aren't they competing on the basis of interest rates, too? Isn't it the case that, as Alan Fox says, "The market won't be allowed to work by those with a stake in high interest rates"? Hasn't competition failed here?[14]

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There are two answers: Some are indeed competing on the basis of interest. But most won't compete on that basis because they want to make credit available to a wide audience.

Some banks do offer substantially lower interest rates. Groups such as Holstein's Bankcard Holders and Fox's Consumer Federation regularly publish lists of low-interest banks, some charging less than 12 per cent. But these banks seldom exploit their rate advantage through mass marketing. All else being equal, banks with higher rates can better afford to offer their cards to a nationwide audience. It is of little use to consumers for a bank to have low rates if they don't hear about it.

Looking at the Costs

The credit card is one of the most convenient ways to borrow money, but it is also one of the costliest ways to lend money. Whereas a home mortgage may run over $100,000 and a car loan over $10,000, the average bank card transaction is $50.[15] Even in today's automated environment, processing constitutes a higher proportion of the transaction costs the smaller the transaction is.

"In fact," says Jerry Craft of the American Bankers Association, "administrative costs can account for more than half of the rate charged on bank credit cards. By comparison, only a little more than 10 per cent of the average mortgage rate can be attributed to administrative costs."[16]

The bigger the loan, the bigger the role that financing costs play in the rate. Financing cost is the price the bank pays to obtain the funds it lends to credit card users. "During the period 1974 through 1984," said Federal Reserve Governor Martha Seger to the House Subcommittee on Consumer Affairs, "financing costs averaged only about three-tenths of total expenses, before taxes, for the credit card function at participating medium- and large-sized banks that issue credit cards. By comparison, financing costs at banks in the same size classes accounted for more than three-quarters of total costs of the commercial lending functions, and for nearly nine-tenths of total costs of mortgage lending."[17] Hence the greater tendency of such large loans to come down with the prime rate.

Craft breaks down the costs incorporated into the prevailing credit card rate roughly as follows: 7 per cent for financing; "up to 5 per cent" for administrative costs, including fraud; and 3 per cent for losses from customers who don't pay their bills. He estimates the opportunity cost of the grace period at an additional 3 per cent. For these reasons Craft prefers to call the credit card rate a "service" rate rather than an interest rate.[18]

Plastic money historically has been among the banks' least profitable financial instruments. In the January 1987 *Federal Reserve Bulletin,* Glenn B. Canner and James T. Fergus show that profits on bank cards trailed those for commercial loans, installment plans, and real estate mortgages in six of the 14 years from 1972 to 1985. Pre-tax net earnings in the period averaged 1.9 per cent a year for credit cards, 2.3 per cent for mortgages, 2.4 per cent for consumer installment debt, and 2.8 per cent for commercial and other loans.[19]

Cards yielded the highest average net returns in only four of the 14 years. Two of these were 1984 and 1985, when profits rose to 3.4 and 4.0 per cent.[20] "But those margins attracted competition, and higher default rates and battles for market share have already lowered profits to a 3 per cent return on assets," cautioned *Business Week* in 1986.[21]

Canner and Fergus add that cards issued by department stores and other retailers have "consistently operated at a loss" through the years.[22] Merchants find store cards useful because they profit from the additional sales that the cards facilitate, not from the interest they earn on account balances.[23]

Given the record, Canner and Fergus conclude, "it seems unlikely that card issuers could absorb significant reductions in revenue from finance charges over the long term merely by accepting lower profits."[24] Lowering ceilings on interest rates would threaten credit-card plans and customers, not just trim fat.

Dealing with Rate Caps

When faced with interest ceilings, card issuers have to adopt strategies no more pleasant than the current interest rates. Banks were squeezed in 1979-81 when the cost of obtaining

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funds rose above the interest they were allowed to charge. According to Seger, "when market costs of funds rose sharply between 1979 and 1981 while credit card rates were restrained by the ceilings, marginal and even average net returns on credit card receivables turned negative."[25]

In response, "Some banks are considering charging card holders a yearly fee to help bring profits back up," said one 1980 report on the credit crunch.[26] Today, annual fees are the norm.

The grace period might be shortened or eliminated. Soon after the Connecticut legislature lowered the credit card rate ceiling from 18 per cent to 15 per cent in June 1986, some banks dropped grace periods. As one bank director put it, "We make money because we charge interest from the date of purchase."[27]

"You told us you're looking for a credit card without a high interest rate. And we hear you!" reads a print ad for a major Pennsylvania bank's Visa card. The chart advertises a "14.0 per cent annual percentage rate." But the grace period on new purchases, says the chart, is "none." Users must pay interest on every purchase whether or not they pay off their whole balance at the end of each month.

Tracy Mullin of the National Retail Merchants Association stresses that "retailers' *effective* rates are well below the *nominal Annual Percentage Rate* that is disclosed. This is because a substantial portion of retail customers pay their bill in full each month, resulting in no finance charge revenue on such accounts" (emphasis in original).[28]

According to Canner and Fergus, the proportion of customers who pay their bills fully each month is 47 per cent,[29] and 48 per cent of users with less than $10,000 in annual family income.[30] Dropping grace periods would effectively increase the cost of credit cards to the millions of customers who treat their plastic as a convenient substitute for cash, clearing their balances at the end of the month.

Card issuers charge merchants a fee for every purchase made on their cards. This "merchant discount" ranges from 2 to 8 per cent,[31] though on small transactions the fee may be a fixed amount. The discount could be raised in response to a rate ceiling, and merchants might raise the prices on their goods to compensate.

Retailers with their own card plans might also raise their prices to make up the loss on such plans. Consider the case of Arkansas, a state with some of the toughest legislation against "usury" and hence some of the lowest credit card rates. Canner and Fergus report that major appliances, which are usually bought at credit, "were found to cost 3 to 8 per cent more in Arkansas—nearly 5 per cent more on average—than in neighboring states."[32]

Interest Rates and Usury Laws: A Brief History

A legacy of the colonial period, tight lids on interest were common among the states until very recently. As late as the mid-1950s "the legal rate was 4 per cent in one state, 5 per cent in five states, 6 per cent in forty states, and 7 per cent in four states," writes Sidney Homer in *A History of Interest Rates*. "A majority still clung formally to the 6 per cent tradition of the Stuart kings."[33]

These usury statutes "did not contemplate modern consumer credit. Under them there was often no legitimate capital available for small personal loans to urban workers," writes Homer.[34]

"In general the loans they demanded were too small and the risk was too great for them to be supplied profitably at rates permitted under the usury laws," observes another analyst. "Lenders thus had to operate illegally if they were to engage profitably in a consumer cash loan business at all."[35]

"Loan sharks" supplied the common man with easy credit at exorbitant interest. Their importance declined when state governments began to permit lenders to charge for small loans at rates higher than the traditional ceilings.[36]

Credit cards followed a similar, if less extreme, pattern of popularization. National plans began two decades ago "as an exclusive service for special customers whose ability to repay their debt was beyond question."[37] As rate ceilings crept up to about 18 per cent, middle- and lower-income earners found it easier to get credit.

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When credit card yields were last squeezed in 1979-81, millions of late payers and delinquent accounts were dropped nationwide.[38] Eligibility standards for new applicants were tightened. Some banks refused new credit card accounts,[39] and others canceled their card plans altogether.[40] In response, many states raised their rate ceilings up to 25 per cent, and some removed them completely.

Today, higher rates in most states permit banks to accept riskier customers. They have reacted to falling funding costs "not by reducing rates, but mainly by increasing the availability of credit cards." This "increased availability reversed the earlier curtailment of such credit that card issuers undertook" as their funding costs rose through 1981.[41]

Applicants with a spotty or limited credit record—primarily, but not exclusively, young and lower-income people—today can shop for banks in states allowing higher interest. A national rate ceiling would limit significantly their access to credit.

Simmons First National Bank of Pine Bluff, Arkansas, with a 10.5 per cent rate as of last March, is usually listed at or near the top of institutions charging low credit card interest. It makes a profit, but only by "being highly selective about whom it issues cards to, by funding the business with cheap local deposits and by taking advantage of its low overhead."[42]

A 1979 Purdue University study comparing credit card holders in Arkansas, Illinois, Louisiana, and Wisconsin found that fewer Arkansans at all levels of education held bank cards than did comparable people in the states with looser rate rules.[43] Surveys indicated that "a higher proportion of consumers reported being rejected for consumer credit compared with consumers residing in states with less restrictive rate ceilings."[44]

While 10 per cent of families with annual incomes of less than $6000 in the other states held bank credit cards, five per cent—half as many—such families in Arkansas had the cards. Ten per cent of Arkansas households headed by a person under age 25 had bank cards, compared to 19 per cent of such households in Illinois, Louisiana, and Wisconsin. Overall, 39 per cent of families in the other states had bank cards, but only 29 per cent of Arkansas families did.[45]

Arkansans who can't get credit in their state have the option to shop for cards with higher rates from banks located outside the state. Because a national rate cap would eliminate that alternative, we could expect its effects on credit availability to be more severe than Arkansas' controls have been for Arkansans.

Populism or Elitism?

Interest rate regulation has a certain populist appeal. Politicians and consumer activists have denounced "usurers" and money-lenders, and made careers out of standing for the "little guy" against the big, bad banks.

Now we have an opposite class-based excuse for controlling interest rates. Said Elgie Holstein about the effect of credit card defaults on card rates: "I think here much of the fault lies with the banks themselves, and not even all the banks, but simply those large interstate institutions that . . . mass-market credit cards. . . . I think if we were simply to look at their loss rates, what you'd find is that the banks that are mass-marketing cards indiscriminately are experiencing the highest loss rates."[46]

Senator Jim Sasser concurred:

> I don't believe that all consumers ought to be advanced credit. I think that credit ought to be advanced to those who are credit-worthy. It appears to me that under the present credit card system, those of us who pay our bills are being asked to also pay the bills of the deadbeats who don't want to pay. . . . [I]f we advanced credit to those who are credit-worthy . . . the rates could come down very substantially, and the banks who advance the credit could make a reasonable profit, which they're certainly entitled to.[47]

"You're exactly right," Holstein told Sasser. "There is some economic level below which consumers not only should not have credit, but are poorly served if they are given credit."[48]

Elitism, too, rationalizes forcing card rates down. We responsible, well-to-do gentlemen ought to enjoy the benefits of credit; let the

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"Abolish" Interest?

The cyclical fluctuations of business are not an occurrence originating in the sphere of the unhampered market, but a product of government interference with business conditions designed to lower the rate of interest below the height at which the free market would have fixed it.

Therefore there cannot be any question of abolishing interest by any institutions, laws or devices of bank manipulation. He who wants to "abolish" interest will have to induce people to value an apple available in a hundred years no less than a present apple. What can be abolished by laws and decrees is merely the right of the capitalists to receive interest. But such decrees would bring about capital consumption and would very soon throw mankind back into the original state of natural poverty.

—LUDWIG VON MISES, *Human Action*

masses make do without it, as in the good old days. Since the banks aren't cutting off the rabble in order to lower our rates, we'll do it for them.

And indeed it is true that default rates on credit card accounts are climbing. A U.S. Chamber of Commerce economist reports that "Bank card industry losses since 1970 have fluctuated between 2 per cent and 4 per cent of credit outstanding. At the end of 1985 they were between 3 and 3.5 per cent; and credit card defaults in 1986 are expected to rise to 4.2 per cent of charges outstanding."[49] Rising losses counteract the effect of falling financing costs on credit card rates.

Though we may find his attitude distasteful, Sasser's point is understandable. Why should good credit risks subsidize poor risks?

An "Optimal" Solution

While politicians, regulators, industry lobbyists, and consumer advocates wrestle over legislative proposals, the market is already resolving the dilemma, accommodating all without government prodding.

In spite of all the factors militating against lower interest rates, some banks have lowered their rates voluntarily. American Express introduced the Optima credit card last spring with a 13.5 per cent rate.

American Express's action was used by some as evidence that the marketplace "is working," that it will and does respond to consumer dissatisfaction by reducing interest rates. *Business Week* dubbed it the "Credit Card War."

"The greater consumer sensitivity to interest rates no doubt figured in Amex's plans to take a plunge into the business with a lower-rate card," cheered *The Wall Street Journal*. "Credit card interest almost certainly will come down. It will come down without rate ceilings. Nothing does it like competition."[50]

However, the Optima card is available only to those who already hold American Express charge cards. The annual fee for Optima is $15. On top of the $45 annual fee for Amex's basic "green" card, it costs $60 a year to get the Optima card.[51]

Applicants must meet more stringent requirements for American Express cards than for other cards to begin with. Indeed, this is part of the "snob" appeal of "membership" in American Express. The company isn't even offering the new card to all "Cardmembers," but only to those who have been members for at least one year and who have "solid credit histories."[52] Thus Amex is marketing Optima at a high annual fee to a select group of proven, safe credit risks.

Despite the hopes of some friends of the credit card marketplace, Optima's introduction has not led to a rate war. "Watch for small interest rate reductions on premium cards—those offering larger credit lines and requiring better credit histories," advises *Fortune*.[53]

The market "is working," but in a different

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manner than its enthusiasts predicted. Amex's gambit may lead to a stratified market where lower-risk customers can borrow at lower rates and higher-risk customers can find credit at higher rates. This would eliminate Sasser's and Holstein's objections against penalizing everyone for a few deadbeats, without drying up credit for the poor and the young.

We already have witnessed steps in this direction. In addition to Optima, there is Citicorp, which has cut rates to "preferred" customers to 16.8 per cent, while the rate for others remains at 19.8. Wells Fargo "dropped its credit card rate from 20 per cent to 17 per cent, but only for customers who've had a Wells Fargo bank card for at least five years."[54]

We could, in classical populist fashion, indict the market for treating better and worse risks differently, and call for a uniformly low rate. But this policy would do a disservice precisely to the "little guy" we would be trying to help. Instead of making low-cost credit available to all, it would dry up credit to poor risks and reserve it to good risks. Market segmentation permits access to credit to people of all backgrounds while rewarding those who pay their bills.

Free-market credit card rates make possible lower prices, greater access to credit, and other conveniences. If we get mad and force the rates down, we'll bear the costs in other forms. One way or another, we must pay for our tastes. □

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A REVIEWER'S
NOTEBOOK

The Birth Dearth

by John Chamberlain

Ben J. Wattenberg, a demographer by profession, did some informal polling of students in a Michigan high school in 1985 to determine their preferences in family size. What he discovered set him off on a world-wide statistical trail that has resulted in a startling book called *The Birth Dearth: What Happens When People In Free Countries Don't Have Enough Babies?* (New York: Pharos Books, 182 pp., $16.95).

The students Wattenberg queried in the Michigan school were born to mothers just after the Baby Boom had ended. The fertility rate of the mothers (2.4 children per woman) was still high enough to guarantee a population increase. But the students who responded to Wattenberg's questions projected a different story for the future. To Wattenberg's question, "How many want to have four or more children?" not a single hand went up. Only a tenth of the students' hands rose in response to the question, "How many want to have three children?" But a whole sea of hands (half of the group) indicated a two child per family preference. Thirty per cent of the students voted a one child per family choice, and a tenth wanted no children at all.

When Wattenberg worked out his arithmetic, the informal expectation data came to 1.6 children per woman, far short of the 2.1 figure for a replacement level. A small Michigan sample is hardly enough to prove a world trend or even to justify a country-wide prophecy. But Wattenberg went home from Michigan to consult the census data. He discovered that for quite some time the total fertility rate in the industrialized nations of the West has been running well below the 2.1 replacement level. Japan went below the replacement line in 1957. West Germany followed Japan in 1970. By 1980 all the major free nations were below the replacement figure.

This evidence was not enough to dispose of Stanford University's Paul Ehrlich's book, *The Population Bomb*, which frightened so many people in the 1960s. Ehrlich, relying on figures from India, Red China, and the Third World countries of Africa, believed he had brought Malthus up to date. The people in the modernized industrial nations might not be reproducing themselves, but immigration would make up the difference. There would be at least a leveling-off, at four children per family, around the world.

Not so, says Wattenberg. In the first place, the industrialized nations of western Europe and America are against unlimited immigration. Secondly, Wattenberg's figures for nations that have been at the total fertility rate of four children per family will, within foreseeable time, fall below the 2.1 level themselves.

How Wattenberg can be sure that people in the less developed countries will cease to reproduce themselves is not immediately apparent. He tells us that fertility in the Third World, though still quite high, has been falling for fifteen years. But has anyone really been able to count the population of China? If the one-child allowance in China per family were, after the current capitalist surge, to be increased to two or three, what would this mean? The AIDS death rate in Africa might compli-

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cate figuring for that continent. So might a cure for AIDS.

Wattenberg is on more certain ground when he sticks to the West. He worries about what will happen when domestic markets shrink as reproduction falls and there is a general "graying" of the population. The optimists say that, with the birth dearth yielding fewer younger workers, there would be more bidding for their services. Youth unemployment would go down as wages went up. More capital would have to be invested to buy equipment to replace the higher cost of labor. The newer equipment would mean higher productivity per worker.

Wattenberg says this is a nice scenario. But the birth dearth would provide fewer buyers. There would be little call for new housing. What would happen to the jobs of people who make furnaces, air conditioners, stoves, refrigerators, electronic garage doors, and all the other things that now go into new houses? And what about the real estate brokers, the mortgage bankers, and the termite inspectors? With Yuppies growing older, they might want to buy up-scale houses. But who, asks Wattenberg, would buy their old houses? With dead people leaving empty houses, the whole problem would be compounded.

Tumultuous Times?

Wattenberg hasn't worked it out industry by industry to reach any final conclusions about the loss of markets due to a declining population. But he is sure the disappearance of markets would lead to tumultuous times. He has some remedies to offer. One would be to subsidize young couples to have more than 2.1 children per family. A $2,000 family allowance per third and fourth child might be a good lure. But the money would have to come from higher taxation or from inflation. Wattenberg has nothing to offer that would avoid these undesirables.

As an economist, Wattenberg might have considered that it is the high-tax philosophy coupled with the "safety net" provision of "entitlements" that has made it necessary for women to go into the labor market in order to keep family living standards from dropping disastrously. The average family today needs two incomes. If this could be changed, families could go back to rearing and educating more children.

Is there any likelihood that the western world is about to abandon the Welfare State philosophy? The world does learn. It might even learn how to live with a birth dearth without any great discombobulation. What happened in England after the Black Death is instructive. The need for workers in the towns in the post-Black Death years killed the feudal system and set capitalism on its course. The human race is adaptable. It is strange that Wattenberg does not mention the Black Death. He might have made something of it. □

TWO ESSAYS BY WILHELM RÖPKE: THE PROBLEM OF ECONOMIC ORDER, AND WELFARE, FREEDOM AND INFLATION

ed. by Johannes Overbeek

University Press of America, 4720 Boston Way, Lanham, MD 20706 1987 • 103 pages • $19.25 hardback, $8.50 paperback

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Reviewed by Richard M. Ebeling

Wilhelm Röpke was one of the most respected and influential German economists in Europe, both before and after the Second World War. In 1933 he delivered a blistering lecture right after Adolf Hitler became Chancellor of Germany; he warned that National Socialism meant the death of culture and humanity in his German homeland. He was given the honor of being one of the first university professors expelled by Hitler. After several years in Turkey, he finally settled in Geneva at the Graduate Institute for International Studies, where he taught until his death in the early 1960s.

During the war he wrote several books, *The Social Crisis of Our Time, Civitas Humana,* and *International Order and Economic Integration,* in which he set out the moral ideal and economic principles of the free society. These and other works of Röpke's bore fruit through their influence on those who implemented the market-oriented policies which led to the "German miracle" of the post-war era.

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Two Essays by Wilhelm Röpke reprints two of the best of Röpke's shorter works. "The Problem of Economic Order" is the text of four lectures delivered at the National Bank of Egypt in 1951. In a brief space, Röpke brilliantly analyzes the alternative meanings of socialism, discusses the nature of the "economic problem," contrasts the market economy with socialism, and criticizes the premises and consequences of Keynesian inflationary policies.

But what is crucial in this essay is how Röpke views the nature of the problem. What he is interested in looking at are not the specifics of particular policy proposals. Rather, the task is to look at the economy in "fundamental terms." Those fundamental terms revolve around the question, "How shall the activities of a vast number of people in a diverse system of division of labor be coordinated so the economic prosperity of the community is assured?" The alternatives, Röpke explains, are market competition or political command. And since socialism is unworkable there is no alternative to the market economy, in which competitive prices serve two functions: to disseminate information so individuals are guided into the correct production activities, and, as income incentives, to harness self-interest to the public interest.

The essay "Welfare, Freedom and Inflation" is the text of a monograph written by Röpke in the mid-1950s. Röpke saw the establishment of the Welfare State as an historical paradox. Prescribed as a remedy to the supposed hardships and traumas of the Industrial Revolution, its implementation in the 20th century occurred at the time when the market economy had overcome its initial 19th century birth pangs. Just when the market was developing the financial wherewithal and economic situations to enable individuals to plan and finance their own welfare requirements, the State interfered and prevented the market solution.

The Welfare State was emerging as a moral and financial monstrosity, according to Röpke. Rather than fostering self-reliance and self-responsibility, society was degenerating into a circular process in which everyone tried to live at the expense of everyone else, through the agency of the State. And as this monetary merry-go-round speeded up, the burden of government expenditures multiplied.

This process always leads to inflation, said Röpke. As government spending exceeds what the populace will tolerate in the form of taxation, the State resorts to the printing press. But in the process, inflation distorts production, destroys the value of existing savings and the incentive for future saving, weakens the economic and moral link between work and reward, and opens the economy to the pressures of special interest groups as each tries to win from the inflationary environment at the expense of others.

The first decade after the Second World War was one of great pessimism for proponents of the market economy, and that pessimism is visible in Röpke's essays. But besides the clarity and soundness of Röpke's arguments, these essays stand as examples of integrity to principle and truth regardless of the apparent intellectual and political odds. □

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The ideal of freedom is to let anyone do anything he pleases, as long as his behavior is peaceful, with government empowered to keep the peace—and nothing more. An ideal objective, true, but one that must be pursued if we would halt the continuing descent of our society from bad to worse. Nothing short of this will suffice. And unless we fully understand the ideal—and what makes for its attainment—we'll tend to settle for powerless, futile little pushes and shoves that yield no more than a false sense of something done.

—**Leonard E. Read**

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—ALEXANDER HAMILTON

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